Part 2 Contract Law CHAPTER 10 Consideration Page 219 CASE OPENER Upper Deck—Contract Liability or Gift? In 1988, the Upper Deck Company was a baseball card company with an idea for a better baseball card: one that had a hologram on it. By the 1990s, Upper Deck was a major corporation whose value was at least a quarter of a billion dollars. In 1988, however, the outlook wasn't bright for Upper Deck, which lacked the funds for a $100,000 deposit it needed to buy some special paper by August 1. Without that deposit, its contract with the Major League Baseball Players Association would have been jeopardized. Upper Deck's corporate attorney, Anthony Passante, Jr., loaned the company the money. That evening, the directors of the company accepted the loan and, in gratitude, agreed to give Passant 3 percent of the firm's stock. Passante never sought to collect the gift of stock, and later the company reneged on its promise. Passante sued for breach of oral contract.1 If you were on the jury, how would you decide the case? (The law of consideration will determine the outcome.) Was the offer of 3 percent of the firm's stock legal consideration for the loan? Or was it a mere gift? Does Upper Deck have a moral obligation to give Passante the stock? If so, is this legally enforceable? LEARNING OBJECTIVES LO 10-1 Define consideration. LO 10-2 Recognize when consideration is required. LO 10-3 Describe what promissory estoppel is and when it can be used. LO 10-4 Describe adequacy of consideration. LO 10-5 Define illusory promise. LO 10-6 Explain past consideration. LO 10-7 Define preexisting duty. LO 10-8 Differentiate between liquidated debt and unliquidated debt. LO 10-9 Describe the concept of accord and satisfaction.

What Is Consideration? LO 10-1 Define consideration. Rule: Consideration is what a person will receive in return for performing a contract obligation. Suppose, for example, that Dan agrees to purchase Mary's car for $1,000. Dan's payment of $1,000 is the consideration Mary will receive for her car. Title to and possession of the car is the consideration Dan will receive in exchange. Consideration can be anything, as long as it is the product of a bargained-for exchange. In a business context, it is often (but not always) money. Other examples of consideration are presented in Exhibit 10-1. Exhibit 10-1Examples of Consideration TYPE OF CONSIDERATION EXAMPLE A benefit to the promisor A promise to stay in a job until a particular project is complete (This is a benefit to the employer.) A detriment to the promisee A promise to your football coach to refrain from riding your motorcycle during football season even though you love riding it A promise to do something A promise to cook dinner for your roommate for the next six months A promise

to refrain from doing something A promise to stop drinking alcohol during exam week Is a promise to refrain from something you are legally entitled to do appropriate consideration for a contract? In Case 10-1, the court considers whether a nephew's promise to refrain from certain vices is adequate consideration for his uncle's promise to pay him $5,000. CASE 10-1 HAMER v. SIDWAY New York Court of Appeals 124 N.Y. 538 (1891) FACTS: William E. Story and his nephew, William E. Story, 2nd, agreed that the uncle would pay his nephew $5,000 if the nephew would refrain from drinking, using tobacco, swearing, and playing cards and billiards for money until he turned 21. When the nephew turned 21, his uncle sent him a letter that indicated that the nephew had earned the $5,000 and that he would hold the money with interest until the nephew became capable of taking care of it responsibly. The nephew accepted the terms. The uncle died 12 years later without having transferred the funds to his nephew. The nephew assigned the funds to Louisa Hamer, who brought suit against the executor of the uncle's estate, Franklin Sidway, to collect the money. Sidway, however, argued that the contract was without consideration to support it and, therefore, invalid. He asserted that the nephew, by refraining from the use of liquor and tobacco, was not harmed but benefited. He further asserted that what the nephew did was best for him to do independently of his uncle's promise and insisted that it followed that unless the uncle was benefited, the contract was without consideration. At trial, judgment was entered in Hamer's favor but was reversed on appeal in Sidway's favor. Hamer appealed. ISSUE: The issue before the court is whether a promise of forbearance (e.g., to refrain from particular activities) can be deemed valid and lawful consideration for a contract. REASONING: Defendant contended that the contract was invalid because it lacked consideration and that there is no consideration unless the promisor is benefited. Such a rule could not be tolerated and is without foundation in the law. Consideration means not so much that one party is profiting as that the other abandons some legal right in the present or limits his legal freedom of action in the future. Now, applying this rule to the facts before us, the promisee used tobacco, occasionally drank liquor, and he had a legal right to do so. He abandoned that right for a period of years based upon the promise of his uncle that for such forbearance he would give him $5,000. We need not speculate on the effort which may have been required to give up the use of those stimulants. It is sufficient that he restricted his lawful freedom of action within certain prescribed limits upon the faith of his uncle's agreement. Now, having fully performed the conditions imposed, it makes no difference whether such performance was actually a benefit to the promisor, and the court will not

inquire into it. DECISION AND REMEDY: It is deemed established for the purposes of this appeal, that on January 31, 1875, defendant's testator was indebted to William E. Story, 2nd, in the sum of $5,000. All concur. SIGNIFICANCE OF THE CASE: Forbearance is sufficient consideration for a valid and enforceable contract. CRITICAL THINKING What difference would it have made in this case had the nephew not had the legal right to drink or smoke? Why is this question crucial to the decision? ETHICAL DECISION MAKING What values is the idea of consideration upholding?

Rules of Consideration LO 10-2 Recognize when consideration is required. The key to understanding consideration is understanding the rules that govern it and their exceptions. We explore these principles in the following sections. LACK OF CONSIDERATION Rule: For a promise to be enforced by the courts, there must be consideration. A court will enforce one party's promise only if the other party promised something (an act, money, etc.) in exchange. For example, in a bilateral contract (a promise for a promise), the consideration for each promise is a return promise. Consider this example: Sue promises to pay Mike $2,000 for his car. Mike promises to sell Sue his car for $2,000. The exchange will be done tomorrow. There is an oral contract. Sue's promise to pay Mike $2,000 for the car is her consideration to Mike. Mike's promise to sell Sue the car for $2,000 is his consideration to Sue. There has been a mutual exchange of something of value—a promise to pay $2,000 and a promise to sell the car for $2,000. Another example of a bilateral contract, or a promise for a promise, occurred when the U.S. government seized control of insurance giant American International Group (AIG). The U.S. agreed to lend AIG up to $85 billion in exchange for nearly 80 percent of AIG's stock. The consideration AIG received was the promise of up to $85 billion in U.S. government loans. The consideration the U.S. received was the promise of almost 80 percent of AIG's stock.2 Page 222 In a unilateral contract (a promise for an act), one party's consideration is the promise, and the other party's consideration is the act. Suppose your professor made the following statement in class: "If any student shows up at my house on Saturday and does the gardening, I will pay that student $100." You show up and do the gardening. The professor's consideration to you is the promise of the payment of $100 on completion of the gardening, and your consideration to the professor is the act of completing the gardening. Once again, there has been a mutual exchange of something of value. Exhibit 10-2 summarizes the consideration in bilateral and unilateral contracts. Exhibit 10-2Type of Consideration Based on Type of Contract TYPE

OF CONTRACT PROMISOR PROMISEE Bilateral A promise A promise Unilateral A promise An act Rule: Promissory estoppel is the legal enforcement of an otherwise unenforceable contract due to a party's detrimental reliance on the contract. LO 10-3 Describe what promissory estoppel is and when it can be used. One exception to the rule requiring consideration is promissory estoppel. Promissory estoppel occurs when three conditions are met: One party makes a promise knowing the other party will rely on it. The other party does rely on the promise. The only way to avoid injustice is to enforce the promise. How does this work? Suppose that on graduation from college, Amanda receives a job offer across the country. She gives up her apartment, cancels all her other job interviews, and moves all her possessions. After arriving, she rents a new apartment and shows up for work. The only problem is that Amanda is told there is no job! May Amanda sue the employer? The answer in most states is yes, under the theory of promissory estoppel. She spent a lot of money in reliance on the job offer. She also moved across the country. Amanda may be able to recover her reliance damages (i.e., money she spent in reliance on the job offer). Promissory estoppel is not awarded regularly, but in the right case, it can provide a remedy when no other remedy exists. CASE Nugget Ruzicka v. Conde Nast Publishing 999 F.2d 1319 (1993) Claudia Dreifus wrote an article for Glamour Magazine relating to therapist-patient sexual abuse. She promised she would not reveal the identity of the subject, Jill Ruzicka, whom she interviewed for the article. Ruzicka argued that Dreifus promised that she would not be "identified or identifiable" in the article. Dreifus refuted this, claiming that she only vaguely promised to do some masking. The article was published with Ruzicka's surname changed to "Lundquist," but included other information that made her "identifiable." In order to prevail on a claim for promissory estoppel, the plaintiff must prove: (1) that the promise was clear and definite; (2) that the promisor intended to induce reliance on the part of the promisee and that such reliance occurred to the promisee's detriment; and (3) that the promise must be enforced to prevent injustice. The district court granted motion for summary judgment against plaintiff, finding that the term "identifiable" was vague and therefore holding that the promise was not "clear and definite" enough to support recovery under promissory estoppel. On appeal, the Eighth Circuit held that to be enforceable under promissory estoppel, a promise need not be as definite with respect to all details as promises forming conventional contracts. The appellate court also pointed out that Ruzicka approved an early draft of the article, but what was ultimately published revealed several identifying facts that Ruzicka had not provided to Dreifus. The Eighth Circuit Court of Appeals ruled in favor of

Ruzicka. The court further opined that, based on U.S. Supreme Court precedent, enforcing the promise would not be unfair to the media defendant: “Where the press feels disclosure of [the] identity of a confidential source is valuable to the story and thus disregards its promise, the payment of compensatory damages is . . . simply a cost of acquiring newsworthy material to be published at a profit.” Page 223 Adequacy of Consideration LO 10-4 Describe adequacy of consideration. Rule: The court seldom considers adequacy of consideration. This rule means that the court does not weigh whether you made a good bargain. Example: Donna purchases a stereo from Celia, a friend in her business law class. Donna pays $500 for the stereo but later realizes that the stereo is not worth even $100. May Donna sue Celia? Typically, the answer is no. It is Donna’s responsibility to do her research and determine what price she should pay. The court will not set aside the sale because she made a bad deal. There is an exception to this rule. Suppose that you are on the verge of bankruptcy, and your creditors are threatening legal action. You know that if you default on your mortgage, car payment, bank loans, credit card payments, and other bills, the court may order your assets to be sold to pay the creditors. Instead of risking this result, you decide to sell your assets. You sell your BMW to your best friend for $50 and your vacation house to your sister for $500. Now, asset-free, you declare bankruptcy, knowing that your creditors will be able to collect nothing. Is this permissible? The answer, of course, is no. In such a case, the court will look at adequacy of consideration. If it appears that the sale of the assets was done to avoid payment to creditors, the court may set aside each sale and sell the assets to pay your creditors. In Case 10-2, the court had to consider whether $1 plus love and affection was adequate consideration for the transfer of property. CASE 10-2 THELMA AGNES SMITH v. DAVID PHILLIP RILEY Court of Appeals of Tennessee, Eastern Section, at Knoxville 2002 Tenn. App. LEXIS 65 FACTS: Smith and Riley lived together out of wedlock for several years. They opened a joint checking account and, over time, both Smith and Riley deposited money into the account. In addition, Riley entered into a lease with Jerry Strickland and Wanda Strickland with respect to a residence owned by them. The lease was accompanied by an option to purchase. Almost four months later, Smith and Riley asked their attorney to prepare a bill of sale and an assignment. In the bill of sale, Riley transferred to Smith a one-half undivided interest in seven items of personal property. Riley also assigned to Smith a one-half undivided interest in the lease and option to purchase with the Stricklands; this interest included a right of survivorship in the one-half interest retained by Riley. The property Riley sold and assigned to Smith in the two agreements was stated in each

to be “for and in consideration of the sum of One Dollar ($1.00) and other and good and valuable consideration, the sufficiency of which is hereby acknowledged.” When the relationship ended, Smith filed suit against Riley in the trial court, seeking the dissolution of their domestic partnership and seeking to enforce the two written agreements with Riley regarding the sale and assignment of property to her. The trial court enforced the agreements and divided the parties’ property. The defendant appealed, arguing that the agreements lacked consideration and were void as they were against public policy. ISSUE: Is $1 plus love and affection adequate consideration for the two agreements between Smith and Riley? REASONING: In the court’s own words (abridged and slightly modified): It is a well-settled principle of contract law that in order for a contract to be binding, it must, among other things, be supported by sufficient consideration. In expounding on the adequacy of consideration, the court has stated that it is not necessary that the benefit conferred or the detriment suffered by the promisee shall be equal to the responsibility assumed. Any consideration, however small, will support a promise. In the absence of fraud, the courts will not undertake to regulate the amount of the consideration. The parties are left to contract for themselves, taking for granted that the consideration is one valuable in the eyes of the law. Quoting the United States Supreme Court, the court went on to state that “[a] stipulation in consideration of $1 is just as effectual and valuable a consideration as a larger sum stipulated for or paid.” Indeed, the consideration of love and affection has been deemed sufficient to support a conveyance. Both the bill of sale and the assignment recite that they are undertaken “for and in consideration of the sum of One Dollar ($1.00) and other and good and valuable consideration, the sufficiency of which is hereby acknowledged.” Facially, the documents are therefore supported by sufficient consideration, as clearly recognized by the Supreme Court. Moreover, Smith’s “society and consortium”—a concept comparable to the love and affection—is further evidence of sufficient consideration to support these conveyances. DECISION AND REMEDY: The judgment of the trial court was affirmed. The case was remanded for enforcement of the judgment and for collection of costs. Costs on appeal were taxed to the appellant, Riley. SIGNIFICANCE OF THE CASE: This case demonstrates that courts will generally not consider the adequacy of consideration. CRITICAL THINKING What is the reasoning of the appellant in terms of why the consideration was not adequate to cause the contracts to be enforceable? What key rule of law did this reasoning overlook? ETHICAL DECISION MAKING What values are being advanced by the logic of the relevant rule of law in this case? In other words, what values prevent the rule of law from being that consideration

must be in an amount similar in value to the item or services being transferred for the contract to be enforceable? Page 224 CASE Nugget Lack of Consideration McLellan v. Charly Court of Appeals of Wisconsin 313 Wis. 2d 623, 758 N.W.2d 94 (2008) The property in dispute is owned by Charly and located between the University of Wisconsin's Harlow Primate Psychology Laboratory and the Wisconsin National Primate Research Center. In July 2004, Rick Bogle, an animal rights activist, met with Charly to ask about purchasing the property. Bogle informed Charly he wanted to use the property for a National Primate Research Center Exhibition Hall, and Charly said he would sell the property to Bogle. Charly and McLellan executed a document titled "Option to Purchase" that granted McLellan the option of purchasing the property for $675,000 within 180 days. The agreement contained detailed provisions on the terms of the sale, including leaseback and repurchase provisions. In June 2005, Bogle organized a rally at the property and posted a sign reading "Future Home of the National Primate Research Exhibition Hall," which contained a picture of a monkey with a device screwed into its skull. Charly had agreed the sign could be put up. Soon after the rally, a university representative called Charly to express its opposition to having the exhibition hall on the property and said the university was still interested in the property. Charly responded that he still wanted $1,000,000 for the property. Shortly thereafter, Charly took the agreement he and McLellan had signed to another attorney. In a letter to McLellan on Charly's behalf, the attorney stated that the option was "voidable and void due to lack of consideration" and offered to enter into an option with different terms. McLellan declined to do that. On August 1, 2005, Charly received a proposed option to purchase from the university under which the university had the option of purchasing the property for $1,000,000. On August 12, 2005, McLellan attempted to exercise his option to purchase the property, but the envelope was returned to him unopened. Through counsel, Charly informed McLellan there was no enforceable option and he declined to sell the property to him. On appeal, Charly contends the circuit court erred in determining the leaseback and repurchase provisions were adequate consideration for the option. Among other reasons, he asserts the consideration required to make an option a binding contract must be separate from the consideration for the sale and therefore cannot be satisfied by the terms negotiated for the sale. With respect to the claims for breach of the option, we conclude that, in order to make the option a binding contract, consideration is required that is separate from the consideration for the sale. We further conclude that the leaseback and repurchase provisions are not consideration separate from the consideration for the sale. Charly

was therefore free to revoke the option. Page 225 Illusory Promise LO 10-5 Define illusory promise. Rule: An illusory promise is not consideration. What is an illusory promise? Suppose Shawn offers to sell Molly his skis for $300. Molly responds, “I’ll look at them in the morning, and if I like them, I’ll pay you.” At this point, Molly has not committed to doing anything. The law considers this an illusory promise—that is, it is not a promise at all. Moreover, an illusory promise is not consideration. Past Consideration LO 10-6 Explain past consideration. Rule: Past consideration is no consideration at all. Consideration is an essential element of a contract. For a court to enforce a promise, both sides must offer consideration. Imagine that you have graduated from college and gotten a great job. After you have worked at the company for five years, your boss says to you, “Because you have done such a great job the last five years, I am going to give you 5 percent of the company stock.” Six months later, you still have not received the stock. May you sue your boss to enforce the promise? The answer is no. For a promise to be enforceable, there must be bargaining and an exchange. In this example, there was no exchange. Work done in the past, by definition, has already been performed. As such, you have given nothing in exchange, and the court will not enforce the promise. You are at the mercy of your boss’s goodwill to keep her promise. A promise cannot be based on consideration that was provided before the promise was made. In Case 10-3, the court must decide whether a husband’s promise to pay his wife’s sisters a share of a life insurance policy for caring for her while she was sick was compensable when the promise was made after the death of his wife. Page 226 CASE 10-3 STATE v. BLAKE Court of Appeals of Ohio, Eighth Appellate District, Cuyahoga County 2015 OHIO 4762 (2015) FACTS: Defendant Kenneth Blake was married to Charlene Hinton-Blake, who died in 2012. Three of Hinton-Blake's sisters, including Yvonne Hinton, assisted her with day-to-day care during a four-year period of illness preceding her death. Following Hinton-Blake's death, it was discovered that Blake was to receive $260,000 from a life insurance policy. Blake agreed to give Hinton-Blake's three sisters half of the insurance proceeds to be divided equally amongst themselves. To this end, Blake and the sisters prepared a notarized document to evidence their agreement. Yvonne Hinton stated that Blake chose to share the insurance proceeds with the sisters because he knew they had helped care for Hinton-Blake prior to her death. Blake received the insurance proceeds in June 2012 and wrote two checks to himself for $100,000 each. He then wrote checks to Yvonne Hinton in the amounts of $22,000 and $100,246. The $22,000 check cleared but the $100,246 check was returned due to insufficient funds. Blake was criminally charged and pled guilty to one count of passing bad checks

and was referred for a presentence investigation report. At sentencing, the trial court ordered Blake to pay restitution in the amount of the bad check, $100,246, and imposed a 180-day jail term along with five years of community control sanctions. Blake appeals, challenging only the order of restitution. ISSUE: Whether the act of passing a bad check can proximately result in economic loss to the victim when that check does not clear. REASONING: We review an order of restitution under the abuse of discretion standard. An abuse of discretion means more than a mere error of law or judgment; it implies that the trial court's attitude is unreasonable, arbitrary, or unconscionable. “[The criminal statute] authorizes a trial court to impose restitution as part of a felony sentence in an amount based on the victim's economic loss.” [It] defines “economic loss” as any economic detriment suffered by a victim as a direct and proximate result of the commission of an offense. Blake argues that the act of passing a bad check cannot proximately result in economic loss to the victim when that check does not clear. We disagree. This court has previously upheld restitution in the amount of a bad check pursuant to a conviction for passing bad checks where economic loss was established. Although the act of passing a bad check can result in economic loss, we find that the trial court abused its discretion in ordering restitution in this instance because the victims suffered no economic loss as their agreement with Blake was not enforceable due to a lack of consideration and that Blake's act of passing the bad check did not result in a completed gift. [T]he formation of a contract requires a bargain in which there is a manifestation of mutual assent to the exchange and a consideration. The record from the trial court's sentencing hearing reflects that there was no consideration to support the underlying agreement between Blake and the victims. The victims' actions in caring for Blake's wife prior to her death cannot satisfy the consideration element because past consideration, having already occurred, cannot be a bargained-for benefit or detriment. DECISION AND REMEDY: We hold that the trial court abused its discretion in ordering restitution in this instance because Blake's agreement with the victims was not supported by consideration and his passing of the bad check did not complete a gift. Therefore, the victims did not suffer the type of economic loss required under [the criminal statute] to support an award of restitution. The judgment of the trial court is reversed, and the order of restitution is vacated. CRITICAL THINKING Given that the promised life insurance proceeds were not legally owed to the sisters (due to lack of consideration), should the criminal case for writing a bad check have been prosecuted? ETHICAL DECISION MAKING Was it ethical that the defendant served time for writing a bad check for money he did not legally owe? Page

227 GLOBAL Context Doug Armand/Getty Images Where is Enforcing Contracts Easiest? Every year, the World Bank publishes its Doing Business Rankings,3 which rate countries by ease of doing business. In the category “Enforcing Contracts,” the United States is ranked number 17. Compare that with Bangladesh, which is ranked 189, or China, ranked number 5. The rankings consider overall ease of enforcing contracts, which includes the time and cost for resolving a commercial dispute through a local first-instance court, the quality of judicial processes index, evaluating whether each economy has adopted a series of good practices that promote quality, and finally, efficiency of the court system. EASIEST RANK Singapore 1 Korea 2 Norway 3 Kazakhstan 4 China 5 Australia 6 Lithuania 7 Estonia 8 United Arab Emirates 9 Austria 10 *United States 17 *Bangladesh 189 Preexisting Duty LO 10-7 Define preexisting duty. Rule: A promise to do something that you are already obligated to do is not valid consideration. There are actually two parts to this rule. First, performance of a duty you are obligated to do under the law is not good consideration. For example, a police officer is sworn to uphold the law. Part of that public duty involves catching suspected criminals. If someone offers a reward for the capture of a suspected criminal, the police officer may not collect the reward because he or she was already obligated to apprehend the suspect. Second, performance of an existing contractual duty is not good consideration. Gene decides to have a pool built in his backyard. Under the existing contract, the pool is to be completed by June 1, just in time for summer. The pool contractor comes to Gene and explains that due to a shortage of workers, the completion date cannot be met; however, if Gene were to pay an extra $5,000, additional workers could be hired and the pool would be completed on time. Gene tells the contractor that he will pay the $5,000. On June 1, the pool is completed, and the contractor asks for the additional $5,000 payment. Is Gene legally obligated to pay? The answer is no. The pool contractor had a preexisting contractual duty to complete the pool by June 1. Gene is under no obligation to pay the additional money. In Case 10-4, the court must consider whether an addendum to a contract agreeing to pay more than the originally agreed to contract price requires additional consideration to be enforceable. Page 228 CASE 10-4 MARGESON v. ARTIS Supreme Court of Iowa (2009) 776 N.W.2d 652 FACTS: John and Jennifer Margeson entered into a contract to sell a weight-loss franchise business called “Inches-A-Weigh” to Theresa Artis. The parties memorialized their agreement in an “Asset Purchase Agreement” executed on October 1, 2004. The purchase price was $125,000, payable at the time of closing. The parties subsequently executed a second document entitled “Sales Agreement Addendum” (addendum). This addendum was

signed on October 7, 2004. It set the price of the sale of the business at $155,000, with $135,000 payable at the time of the closing. Of the amount to be paid at closing, $125,000 was identified as the proceeds of a loan secured by Artis from First Bank, and $10,000 was to be paid in cash. The remaining portion of the purchase price was to be paid to the Margesons in monthly installments in amounts based on sales. The closing was set for October 18, 2004. On that date, Artis tendered the $125,000 proceeds of the loan from First Bank, together with an additional $10,000 from two personal checks drawn on her bank. The parties ran into some disputes following the closing. Artis stopped payment on one of the personal checks delivered at the time of closing and stopped making the monthly payments in March 2005. The Margesons responded by filing a lawsuit for breach of the addendum. The Margesons eventually filed a motion for summary judgment. They claimed there was no genuine issue of material fact as to any of the elements of their claim for breach of contract. Artis asserted the addendum was unenforceable because it was not supported by consideration. The district court found the addendum was supported by consideration. It granted summary judgment to the Margesons. Artis appealed, and we transferred the case to the court of appeals. The court of appeals affirmed the ruling of the district court. We granted further review. ISSUE: Whether an addendum to a contract modifying the purchase price just prior to closing is supported by consideration? REASONING: Justice Cady: . . . It is fundamental that a valid contract must consist of an offer, acceptance, and consideration. Generally, the element of consideration ensures the promise sought to be enforced was bargained for and given in exchange for a reciprocal promise or an act. The Margesons seek to recover under the terms of the addendum. In doing so, they seek to enforce the promise by Artis to purchase the business for $155,000. Artis argues the terms of the addendum are not a legally binding part of the contract. More precisely, Artis argues the addendum, which was a modification of the original agreement, requires independent consideration to be binding. Artis argues there was no consideration in this case because the Margesons had a preexisting duty under the first agreement to sell the business to her for $125,000. The Margesons argue additional consideration was present to support the modification. Generally, a promise to perform a preexisting duty does not constitute consideration. No consideration exists when the promisee has a preexisting duty to perform because a promisor is already entitled to receive the promise made by the promisee and the promisee has only made what amounts to a gratuitous promise. We have specifically applied this rule to preexisting contractual obligations when parties to an original contract agree to modify that

contract. Artis argues the addendum was unenforceable because it arose only from a desire by the Margesons to obtain more money for their business than agreed in the original purchase agreement. Although Artis agrees she promised in the addendum to pay $30,000 more for the business, she claims the Margesons did not provide a return promise or performance in exchange for her promise to pay more money. The Margesons argue the addendum is supported by three instances of additional consideration: (1) a financing plan, (2) flexibility in payments, and (3) the ability to renegotiate the payment terms. The district court found these provisions to amount to independent consideration, as did the court of appeals. New financing terms can constitute sufficient consideration to support the modification of a preexisting obligation. Yet, the new financing terms would need to apply to the preexisting obligations under the original agreement to satisfy the consideration requirement needed for the modification that the promisee promises to do something the promisee has no prior legal obligation to do or refrain from doing something that the promisee has a legal right to do. In this case, all three new financing terms pertained only to the promise made by Artis to pay the additional $30,000. Thus, the new financing terms under the modification were merely part of the new promise by Artis to pay an additional sum of money for the business. The terms did not establish that the Margesons promised to do something they were not otherwise already obligated to do (sell business for $125,000 due at closing) or promised to refrain from doing something they had a legal right to do. Of course, the Margesons would have furnished new consideration for the modification if the financing terms under the modification applied to part or all of the $125,000 due at the time of closing of the original agreement. Under such a case, the Margesons would have furnished consideration because they would have promised to refrain from doing something (giving up the right to receive the original purchase price in a lump sum at the time of closing) that they had a legal right to do. Consequently, the modification was nothing more than a unilateral price hike. Here, Artis promised additional compensation for the same performance by the Margesons. Thus, the Margesons cannot enforce the promise by Artis to pay more money for the business because they failed to produce any evidence to show they promised to do something more than they had promised to do under the first agreement. The addendum does not reflect independent consideration. The Margesons were not entitled to summary judgment on their breach of contract claim. DECISION AND REMEDY: Court of appeals vacated; district court judgment reversed; case remanded. SIGNIFICANCE OF THE CASE: A change of the terms of consideration to an already negotiated contract (in this case, an

addendum just prior to closing) can be precarious. If previously agreed to terms of consideration are changed for one, then the parties must be certain that there is new and/or additional consideration from all parties to the contract. Absent new and/or additional consideration by all, there is a risk that the court will see the contract as it did this one—unsupported by consideration and therefore unenforceable. CRITICAL THINKING Do you believe the court made the correct decision? How do you think most business owners would feel about the outcome? ETHICAL DECISION MAKING Is it ethical to use a legal argument to escape from a contract modification that you agreed to? Why or why not? How would you feel about the outcome if you were the sellers of this small business? Page 229 Exceptions to the Preexisting-Duty Rule There are exceptions to the preexisting-duty rule: Unforeseen circumstances Additional work UCC—sale of goods If unforeseen circumstances cause a party to make a promise regarding an unfinished project, that promise is valid consideration. Let's once again consider the pool example. Suppose that Gene's pool contractor has been building pools in Gene's neighborhood for the past 20 years. During all that time, the contractor has never had any problem with rocks—until now. While bulldozing the hole for the pool in Gene's backyard, the pool contractor hits solid rock. He estimates that it will cost an additional $5,000 to clear the rock by using jackhammers and possibly even dynamite. The contractor explains that he is sorry, but unless Gene agrees to pay the additional money, he will not be able to finish the pool. Gene agrees to pay. When the pool is completed, the contractor asks for the additional $5,000. Will a court enforce this promise? The answer is yes. Even though the contractor is completing only what he was obligated to do under the contract, neither party knew of the solid rock. The contractor has given additional consideration (removal of the rock), and Gene will be held to his promise to pay the additional money. If a party to a contract agrees to do additional work (i.e., more than she is obligated to do under the contract), the promise is valid consideration. In the pool example, if the contractor asks Gene for an additional $10,000 but agrees to add a waterfall and a deck to the pool, the promise to do the additional work is consideration. If Gene agrees to pay the $10,000, that is his consideration. Both parties are now bound.

Partial Payment of a Debt LO 10-8 Differentiate between liquidated debt and unliquidated debt. Page 230 Partial payment of a debt may or may not be

valid consideration, depending on whether the debt is liquidated or unliquidated. In a liquidated debt, there is no dispute about the fact that money is owed and the amount of money owed. Example: Natalie owes $3,000 on her credit card. She calls the credit card company and explains that she is a poor student and cannot afford to pay the entire $3,000. The credit card company agrees to accept $2,000 as payment in full. The following month, Natalie receives her new credit card statement showing that she owes the remaining $1,000. May the credit card company collect the additional $1,000? Yes! A creditor's promise to accept less than owed, when the debtor is already obligated to pay the full amount, is not binding. LO 10-9 Describe the concept of accord and satisfaction. The exception to the rule regarding liquidated debt occurs when the debtor offers different performance. Suppose Natalie offered the credit card company her car in full settlement of the $3,000 debt. If the credit card company accepts, regardless of the value of the car, the debt is paid in full and the credit card company may not sue Natalie for any additional money. In an unliquidated debt, the parties either dispute the fact that any money is owed or agree that some money is owed but dispute the amount. A dispute over an unliquidated debt may be settled for less than the full amount if the parties enter into an accord and satisfaction. For an accord and satisfaction to be enforceable, three requirements must be met: The debt is unliquidated (i.e., the amount or existence of the debt is in dispute). The creditor agrees to accept as full payment less than the creditor claims is owed. The debtor pays the amount they have agreed on. CASE Nugget Accord and Satisfaction Haynes v. DaimlerChrysler Corp. Supreme Court of Appeals of West Virginia 228 W. Va. 441 (2011) On January 22, 2006, Elgene Phillips was driving his 1998 Dodge Ram 1500 when the vehicle hydroplaned, ran off the left side of the road through a guardrail, and rolled over. Mr. Phillips died as a result of the accident. Gloria Phillips was a passenger in the truck. She testified that Mr. Phillips's seatbelt was latched prior to the accident but became unlatched during, and as a result of, the accident. An expert witness testified that Mr. Phillips would not have sustained fatal injuries if his seatbelt had remained latched during the accident. Ms. Phillips, whose seatbelt did remain latched during the accident, suffered only minor injuries. As a result of mediation, the parties reached a settlement and entered into a handwritten agreement. Defendant was to pay plaintiff $150,000 for a full and final settlement of all claims, and the agreement was to be confidential. The plaintiff thereafter received two checks, one for $65,000 from Autoliv (the seatbelt manufacturer) and another for $85,000 from Chrysler. The second check, for $85,000, was returned for insufficient funds because Chrysler had just filed

for bankruptcy. The handwritten settlement agreement provided that “Defendants” would pay the plaintiff $150,000. No apportionment between defendants was listed in the settlement agreement. Plaintiff asked the court to force Autoliv to pay the remaining $85,000. Autoliv argued that plaintiff’s cashing of the $65,000 check was an accord and satisfaction of Autoliv’s portion of the debt; therefore, Autoliv was not responsible for the remaining $85,000. The plaintiff argued that when the $65,000 check was cashed, plaintiff was not aware that Autoliv meant the check to be the full and final payment of what was owed to plaintiff. The Supreme Court of Appeals of West Virginia agreed with the plaintiff and ordered Autoliv to pay the remaining $85,000. Page 231 Rule: An accord and satisfaction is an arrangement between contracting parties whereby one of the parties substitutes a different performance for his or her original duty under the contract. The promise to perform the new duty is the accord, and the actual performance of that new duty is the satisfaction. Under such circumstances, the debt is fully discharged. The accord is the new agreement to pay less than the creditor claims. The satisfaction is the payment, by the debtor, of the reduced amount. If the debtor fails to pay the new amount, the creditor may then sue for the full amount of the original debt. It pays to keep your word. One way that people sometimes attempt to create an accord and satisfaction is by sending a check to the creditor and writing “paid in full” on the check. Under common law, in many states, this did create an accord and satisfaction, and if the creditor cashed the check, he or she was bound to accept the smaller amount as payment in full. The UCC, however, has changed the scope of this rule. Under UCC Section 3-311, effective in 30 states, the rule remains in place but has two major exceptions. First, in cases of business organizations, thousands of checks may be received each day. To protect themselves, businesses may notify their debtors that any offer to settle a claim for less than the amount owed must be sent to a particular address and/or person. If you check the terms printed on your credit card statement, you will likely find language directing you to send such payments to a different address and person than those to which regular payments are sent. This safeguard protects businesses from inadvertently creating accord-and-satisfaction agreements. Here is an example of the wording you might find on a credit card statement: Conditional Payments: Any payment check or other form of payment that you send us for less than the full balance that is marked “paid in full” or contains a similar notation, or that you otherwise tender in full satisfaction of a disputed amount, must be sent to [address omitted]. We reserve all rights regarding these payments (e.g., if it is determined that there is no valid dispute or if any such check is received at

any other address, we may accept the check and you will still owe any remaining balance).4 Second, if a business does inadvertently cash a paid-in-full check, the business has 90 days from the date it cashed that check to offer repayment in the same amount to the debtor. For example, if John owed $3,000 to his credit card company and he sent the company a $2,000 check marked “paid in full” to the correct address and person, the credit card company has 90 days to offer to repay John the $2,000. Once the offer has been made by the business, no accord and satisfaction exists. CASE OPENER WRAP-UP Upper Deck—Contract Liability or Gift? As you know from the Case Opener, Passante sued Upper Deck for breach of oral contract. At trial, the jury awarded him close to $33 million—the value of 3 percent of Upper Deck’s stock at the time of the trial in 1993. Upper Deck appealed. As a matter of law, any claim by Passante for breach of contract is necessarily based on the rule that consideration must result from a bargained-for exchange. In this case, the appellate court held that if the stock promised was truly bargained for, then Passante had an obligation to give Upper Deck the opportunity to have separate counsel represent it in the course of that bargaining. The legal profession has certain rules regarding business transactions with clients. Bargaining between the parties might have resulted in Passante’s settling for just a reasonable finder’s fee. All Passante’s services in arranging the $100,000 loan for Upper Deck had already been rendered (even though the board had not formally accepted the loan) before the idea of giving him stock came up. There was no evidence he had any expectation of receiving stock in return. If there is no expectation of payment by either party when services are rendered, the promise is a mere promise to make a gift and not enforceable. The promise of 3 percent of the stock represented a moral obligation but was legally unenforceable. Page 232 PRACTICAL TIPS for Business Managers In many states, an option contract for the purchase of real property requires consideration that is separate from the consideration required for the sale of the land itself. When in doubt, consult a local real estate attorney. Negotiate well. Absent fraud (or other extenuating circumstances) the courts will not review adequacy of consideration. If you make a bad deal, you are stuck with it. Never cash a check marked “paid in full” (or with any similar language) unless you are happy to accept that amount and forgo collection of any balance owed to you.

SUMMARY What Is Consideration? Consideration is something of value given in exchange for something else of value; it must be the product of a mutually

bargained-for exchange. Rules of Consideration For a promise to be enforced by the courts, there must be consideration. A court will enforce one party's promise only if the other party promised something (an act, money, etc.) in exchange. Promissory estoppel occurs when one party makes a promise knowing the other party will rely on it, the other party does rely on it, and the only way to avoid injustice is to enforce the promise. The court seldom considers adequacy of consideration. This means that the court does not weigh whether you made a good bargain. An illusory promise is not consideration (i.e., it is not a promise at all). Past consideration is generally no consideration at all. A promise cannot be based on consideration that was provided before the promise was made. The preexisting-duty rule provides that when a party does what it is already legally obligated to do, there is no consideration because there has been no detriment. Partial Payment of a Debt In a liquidated debt, there is no dispute about the fact that money is owed and the amount of money owed. In an unliquidated debt, the parties either dispute the fact that any money is owed or agree that some money is owed but dispute the amount. For an accord and satisfaction to be enforceable, three requirements must be met: (1) The debt is unliquidated (i.e., the amount or existence of the debt is in dispute); (2) the creditor agrees to accept as full payment less than the creditor claims is owed; and (3) the debtor pays the amount they have agreed on. The accord is the agreement, and the satisfaction is the payment of the reduced amount.

Point/Counterpoint Should the Courts Require Consideration to Create a Binding Contract? YES NO Requiring consideration gives the court a way to distinguish binding promises from nonbinding promises. Without a requirement of consideration, there would be no way to distinguish between a promise made as a gift and a promise made as part of a contract. The rules of consideration have been established for many years and precedent should be followed. We have enough exceptions to the rule requiring consideration to make enforcement of the rule fair. For example, if a promise was made and there was expectation of economic benefit, some courts will permit enforcement of the promise under the moral obligation exception. If we suddenly did not require consideration to create binding contracts, the courts would fill with civil cases of people trying to fulfill all kind of promises. There is no need to distinguish between binding promises and nonbinding promises if all promises are enforced. All promises should be enforced. If a person makes a promise, the timing of the promise should not make a difference. For example, if Andreza's aunt promises her $50,000 for "all you have done

for me these last five years," why should Andreza be denied the $50,000 because it was based on acts she had done in the past? (i.e. past consideration). The right thing to do, both ethically and morally, would be to enforce this promise whether or not Andreza did the acts with expectation of payment. Under the current exception, if an act was done with expectation of payment, it meets the moral obligation exception in some states. This exception rewards those who expect something when they do something good and punishes those who do the right thing with no expectation of reward.

Questions & Problems List the four types of consideration described in the text. What is required to prove promissory estoppel when consideration is missing? Can $1 be adequate consideration? Why or why not? List and describe the three exceptions to the preexisting-duty rule. List the three elements of accord and satisfaction. Appellant is a temporary-worker staffing company servicing client companies throughout the El Paso region. Jamrowski was a temporary worker for one of Appellant's client companies. Although the temporary workers work on-site for Appellant's client companies, the workers are ultimately employees of dmDickason and are subject to Appellant's corporate policies and procedures. The dmDickason Employee Handbook ("Handbook") contains an page at the outset of the document stating that the employee acknowledges the Handbook does not cover all corporate policies in detail. The acknowledgment page also contains the following language: "I also understand that the provisions in the Handbook may be changed at any time by dmDickason and that in certain circumstances; dmDickason may choose not to follow the provisions in the Handbook." Two copies of the Dispute Resolution and Arbitration Policy Agreement ("Agreement") are contained in the Handbook and listed in the Handbook's table of contents as attachments. One copy must be returned to dmDickason and one is for the employee's records. The Agreement requires employees to submit any disputes between them, dmDickason, or dmDickason's client companies "relating to or arising out of an employee's recruitment, hiring, employment, or . . . termination of employment[]" to binding arbitration. The Agreement contains the following provision: "dmDickason may change or modify this arbitration policy from time to time without advance notice or the consent of employees. However, with respect to any claim for which a demand for arbitration has been filed with the AAA, dmDickason will not modify or change the agreement between you and dmDickason to use final and binding arbitration to resolve employment-

related disputes without notifying you and obtaining your agreement to such changes.” Jamrowski filed suit in district court and brought employment claims against Appellant and Appellant’s client company. Appellant moved to compel arbitration, which the trial court denied. An appeal followed. Is the arbitration clause an illusory promise? Why or why not? Source: Temp. Alternatives, Inc. v. Jamrowski, 511 S.W.3d 64 (2014). The parties orally contracted for Pendergrass Construction to perform grading and other work on Ingram’s property for the price of $2,500.00. After Pendergrass Construction began the work, Ingram requested work. The parties did not discuss any additional payment for this work. After the work was complete, Pendergrass Construction sent Ingram an invoice for $9,073. Ingram told Pendergrass Construction he would not pay that amount and sent them a cashier’s check marked “pd in full ” for $1,500, which was the balance due on the original $2,500 price. Pendergrass Construction marked through the “pd in full” notation on the check, cashed the check, and then notified Ingram that they considered the check to be a credit against the total amount owed. Pendergrass Construction later brought suit against Ingram to refute an accord and satisfaction and argued that the parties entered into two separate contracts, one for $2,500 and another for additional work above and beyond the original agreement. The trial court ruled in favor of Pendergrass Construction. This appeal followed. How should the court decide? Do you believe the parties entered into an accord and satisfaction? Why or why not? Source: Pendergrass v. Ingram, 2016 Tenn. App. LEXIS 440 (2016). Page 234 Meghann Patrick is a former employee of Altria Group Distribution Company. After her employment was terminated, Patrick sued Altria and a supervisor at Altria, alleging employment-related claims under the Missouri Human Rights Act. The defendants moved to compel arbitration and stay the civil action. The circuit court denied the defendants' motion, and they appealed. Patrick was hired by Altria in November 2007 as a Territory Sales Manager. At the time she began her employment, Patrick agreed to a dispute resolution program which included an arbitration provision. In February 2012, Altria distributed to employees a revised dispute resolution agreement, which superseded the earlier agreement. Under the agreement all workplace disputes were subject to mandatory and binding arbitration. The agreement gave Altria the power to unilaterally amend or terminate the dispute resolution program. In this case, the agreement gives Altria the unilateral right to make "material amendments" to the dispute resolution agreement, which may include "change[s] in the allocation of fees and costs, the Disputes covered, or the limitations on remedies." Altria's right to make material and unilateral modifications includes: (1) the

agreement does not limit material modifications to prospective-only application; and (2) the agreement does not require Altria to give advance notice to employees of material modifications. Altria terminated Patrick's employment in March 2016. Patrick filed an administrative complaint against Altria and supervisor John Hartnett with the Missouri Human Rights Commission. Following receipt of a right to sue letter from the Commission, Patrick filed suit against Altria and Hartnett. Altria filed a Motion to Compel Arbitration and Stay Action. Patrick opposed the motion. She argued, among other things, that the dispute resolution agreement was not enforceable because it was not supported by adequate consideration. How should the appellate court rule on the motion to compel arbitration? Do you believe there was adequate consideration for the revised agreement to arbitrate? Why or why not? (Patrick v. Altria Group Distrib. Co., 570 S.W. 3d 138 (2019)). Byers acquired and owned substantial tracts of ranchland, including the family ranch where Byers lived. For some time, Byers's son (and, thus, Bouton's brother) managed most of the ranching operations. In 2003, Byers became concerned about his son's conduct and how he was handling some of the business matters entrusted to him. Byers asked Bouton, his daughter, to help in assessing the status of the operations. At the time, Bouton held a tenure-track teaching position on the Washburn University School of Law faculty and earned about $100,000 a year. Bouton began helping Byers with the ranching enterprise. She went to the ranch several times a week and wrapped work on her father's business around her teaching duties. In late 2003, Byers showed Bouton a revised will and trust he had prepared leaving the ranch operations to her. According to Bouton, Byers said he wanted her to carry on the ranching business after his death. After two years, Byers convinced Bouton to quit her law professor job, move her family to the ranch, and run the business full time. He assured her that she needn't worry about money because he was bequeathing her land worth more than a million dollars. In December 2008, the two argued over issues related to the ranch and Byers told Bouton her services were no longer needed. The family left the ranch and Bouton returned to the Washburn Law School faculty in a part-time teaching position without any possibility of tenure. About 14 months later, Byers informed Bouton that he had contracted to sell the family ranch —the last of his land holdings except for 10 acres—for $1.2 million. So far as Bouton understood, Byers no longer owned any land that she might inherit. In November 2011, Byers signed a new trust that upon his death would distribute all of his assets to charitable foundations to provide college scholarships. Byers effectively disinherited Bouton. Bouton sued her father, Byer, to enforce his promise that she would inherit the family farm, worth

over $1 million. On what legal theory did Bouton sue? How do you think the court resolved the matter? Source: Bouton v. Byers, 50 Kan. App. 2d 34, 321 P.3d 780 (2014). Page 235 Joana Perez began working for Datamark in January 2005. She received two booklets at orientation, “Non-Staff Employee Handbook” and “Summary Plan Description.” She did not read either one of them. According to the human resources director, Perez also received a “Problem Resolution Program” booklet (the PRP) that described company dispute resolution policies and procedure. Perez denied receiving it, but she did sign the “Receipt and Arbitration Acknowledgment” form, which was maintained in her personnel file. Her signature acknowledged that she had received and read (or had the opportunity to read) both “Summary Plan Description” and the PRP. She also acknowledged that an arbitration policy required the submission of all employee-related disputes to an arbitrator in accordance with the procedures described in the PRP. Datamark reserved the right to revoke or modify the PRP in writing at any time as long as the writing was signed by an officer of the company and articulated an intent to revoke or modify a policy. Perez learned she was pregnant in August 2005. While employed full-time, she began to miss work due to pregnancy difficulties. She was discharged on October 21, 2005, and filed suit alleging unlawful discrimination because of her gender and/or pregnancy. Perez also alleged that Datamark intentionally or recklessly engaged in extreme and outrageous behavior that caused her severe emotional distress. Datamark filed a motion to compel arbitration. In her response to the motion, Perez alleges that the arbitration agreement is illusory because Datamark could unilaterally change or terminate the agreement without prior notice to the employees. Do you believe the agreement to arbitrate is illusory? Why or why not? Source: In re Datamark, Inc., Relator, Court of Appeals of Texas, Eighth District, El Paso, 296 S.W.3d 614; 2009 Tex. App. LEXIS 794 (2009). Peter and Laureen were married on February 16, 1975; they are the parents of two adult children, Amanda and Matthew. In 1996, Peter and Laureen were on the verge of seeking a divorce. Peter had not been living in the marital home for almost two years. According to Laureen’s testimony in the instant case, Peter had been verbally abusive to her; moreover, Peter admitted to having engaged in extramarital affairs. When Peter requested permission to return to the marital home, several conversations took place between Peter and Laureen. In May of 1996, there was a family meeting regarding Peter’s request. That meeting was attended by Peter, Laureen, and the two children. It was Laureen’s testimony that, during this meeting, she agreed to allow Peter back into the marital home if he fulfilled three conditions: (1) continued alcohol treatment counseling; (2) contribution to family expenses; and (3)

waiver of any claim to Laureen’s pension. The agreement was made orally. Laureen and the two children testified that Peter assented to these three conditions. Peter, for his part, acknowledged that the family meeting had taken place and that he had agreed to the first two conditions, but he denied that they had discussed any waiver of his interest in Laureen’s pension. Shortly after the family meeting, Peter returned to the marital home. In November of 2002, Laureen and Peter separated for the final time. Laureen obtained a restraining order against Peter, which called for his removal from the family home and prohibited him from having any contact with Laureen. Ultimately, the trial court awarded Laureen 80 percent of the family assets and denied Peter any portion of Laureen’s pension. Peter claims that he never agreed to condition #3 and that he is entitled to a portion of Laureen’s pension. Is the oral contract stated above enforceable? And are Peter’s three alleged promises sufficient consideration to permit the court to uphold the conditions of the contract and deny Peter’s request for a portion of Laureen’s pension? How should the court rule? Source: Deangelis v. Deangelis, 923 A.2d 1274 (R.I. 2007). Charles Houser began working for appellee, 84 Lumber Company L.P. (84 Lumber), in 1985. In 1998, Houser became an outside salesman with 84 Lumber, and his compensation changed from a set salary to commission based on his sales. At that time, Houser signed a noncompete agreement, which prohibited him from engaging in sales activities with a competitor of 84 Lumber within a 25-mile radius of 84 Lumber’s Macedonia store for a two-year period following the conclusion of his employment with 84 Lumber. In June 2008, Houser signed a contract providing a set weekly draw and yet another noncompete agreement. In March 2009, Houser left 84 Lumber and, almost immediately thereafter, began working for Carter Lumber, a competitor of 84 Lumber. 84 Lumber filed a lawsuit alleging that Houser had violated the noncompete agreement. The essential question is whether the 2008 noncompete agreement was supported by adequate consideration. “[A] restrictive covenant is enforceable if supported by new consideration, either in the form of an initial employment contract or a change in the conditions of employment.” 84 Lumber Company argued that Houser’s continued employment was adequate consideration for the new noncompete agreement. Do you agree? Why or why not? Source: 84 Lumber Co., L.P. v. Houser, 2011 Ohio 6852 (2011). Page 236 In December 2011, Jimenez began working for Cintas as a Fire Service Technician. She continued in this capacity until June 2012, when Cintas terminated her employment. On July 18, 2013, Jimenez filed a petition against Defendants in the Circuit Court of St. Louis County, challenging her termination and alleging that during her employment she suffered

discrimination and harassment by Baker and Fitzsimmons, who acted in their capacity as managers for Cintas. On August 26, 2013, Defendants filed a motion to compel Jimenez to arbitrate her claims against Cintas, attaching a document entitled “Missouri Employment Agreement for Sales, Service and Marketing Personnel” (“Agreement”). The first page of the Agreement is dated December 12, 2011, and contains Jimenez’s purported signature. Section 8 of the Agreement states that disputes “between Employee and Employer concerning whether either party at any time violated any duty, right, law, regulation, public policy, or provision of this Agreement” that cannot be resolved in good faith, must be “resolved through impartial and confidential arbitration.” The Agreement requires the arbitration of all claims except those expressly excluded by Cintas. Defendants argue that the parties formed a valid arbitration agreement providing two separate types of consideration: (1) Cintas’s offer of “new” or “future” at-will employment; and (2) Cintas’s and Jimenez’s mutual promises to arbitrate. Jimenez responds that the arbitration agreement is effectively devoid of consideration and therefore invalid because her employment relationship with Cintas was “at-will,” and Cintas’s promise to arbitrate was not mutually binding. How should the court rule? Do you think that new or future “at-will” employment should be adequate consideration for a contract? Why or why not? Source: Jimenez v. Cintas Corp., 475 S.W.3d 679 (Mo. Ct. App. 2015).

Part 2 Contract Law CHAPTER 11 Capacity and Legality Page 237 CASE OPENER Apple’s Questionable Contract Parents of minors took Apple to court in 2012 for supplying game applications on iPhones that were free but through which users could purchase in-game currencies. Apparently, parents would log on to the games, but within a subsequent 15-minute time frame, the minors using the game would rack up bills ranging from $99.99 to $338.72 at a time. Apple stated that although minors were downloading these applications and in-game currency, the contract in question was actually the Terms of Service between the parents and Apple. According to the Terms of Service, any unauthorized log-on on one’s account or unauthorized purchases by anyone on the account was the responsibility of the account holder. On the other hand, the parents argued that all application and in-game purchases made by minors were separate contracts that may be disaffirmed by a parent or guardian. Apple also argued that a contract as the parents were describing it could not legally exist in that, as the parents described the scenario, the contractual offer was made to parents in the Terms of Service, yet accepted by the children, and

consideration was provided by the parents (the original offerees).1 Do the individual purchases made by the minors indeed qualify as separate contracts between Apple and the minors? Even if the purchases were contracts between the minors and Apple, could the parents void these contracts? LEARNING OBJECTIVES LO 11-1 Recognize circumstances wherein a minor would have a limited capacity to enter into a contract. LO 11-2 Explain how a contract created when one is a minor may be ratified after one is no longer a minor. LO 11-3 List the conditions under which a contract is unenforceable by law. LO 11-4 Describe instances in which unfairness affects a contract's enforceability. LO 11-5 Recall the legal effect of entering into a contract for illegal purpose. LO 11-6 Describe the characteristics of a severable contract.

Capacity This chapter examines the third and fourth elements of a contract. Capacity is the third element of a legally binding contract. A person who has legal capacity to contract is one who has the mental ability to understand his or her rights and obligations under a contract and therefore will presumably be able to understand how to comply with the terms of the agreement. Incapacity, or incompetence, as it is sometimes called, is some sort of mental or physical defect that prevents a natural person from being able to enter into a legally binding contract. Depending on the nature and extent of the defect, a person may have either no capacity, and therefore any attempted contract is void, or limited capacity, resulting in the ability to form only voidable contracts. Historically, people with limited or no capacity included married women, minors, and insane persons. Through statutes, other categories were added for classes of people for whom guardians had been appointed, such as habitual drunkards, narcotic addicts, spendthrifts, the elderly, and convicts. Today, married women have been removed from the category of those lacking contractual capacity, although in a few states their capacity to enter into certain kinds of contracts is still limited. In this section of the chapter, we explain the current law limiting the capacity of some categories of persons to enter into legally binding agreements. Exhibit 11-1 summarizes these various types of incapacity. Minors LO 11-1 Recognize circumstances wherein a minor would have a limited capacity to enter into a contract. One of the oldest limitations on capacity is the ability of minors to enter into only voidable contracts. Today, in all but three states, a minor is someone under the age of 18.2 In most states, however, a person is given full legal capacity to enter into contracts when he or she becomes emancipated before reaching the age of majority. Emancipation occurs when

a minor’s parents or legal guardians give up their right to exercise legal control over the minor, typically when the minor moves out of the parents’ house and begins supporting himself or herself. Often the minor will petition the court for a declaration of emancipation. In most cases, when minors marry they are considered emancipated. BUT WHAT IF. . . WHAT IF THE FACTS OF THE CASE OPENER WERE DIFFERENT? Let’s say that in the Case Opener the court decided that all of the purchases made by the minors were indeed contracts between the minors and Apple. Let’s say that the parents attempted to void the contracts themselves because they are technically the minors’ legal guardians. Would such a move be legal? Why or why not? Disaffirmance of the Contract Because their contracts are voidable, minors have the right, until a reasonable time after reaching the age of majority, to disaffirm, or avoid, their contracts. No formalities are required to disaffirm the contract; the minor need only manifest an intention to rescind the contract, either by words or by actions. However, the minor must avoid the entire contract; they cannot choose to disaffirm only a portion of it. Case 11-1 provides an illustration of how the court sometimes grapples with the issue of whether to allow a minor to disaffirm a contract. Page 239 CASE 11-1 ADRIAN LOPEZ v. KMART CORPORATION United States District Court for the Northern District of California 2015 U.S. Dist. Lexis 58328 (2015) FACTS: In April of 2013, Kmart hired Adrian Lopez as a cashier in its Concord, California, store. At the time, Lopez was 16 years old and a sophomore in high school. Before Lopez began working, he was required to participate in Kmart’s online training program. During the program, Lopez was presented with an electronic arbitration agreement. The agreement stipulated any disputes Lopez might have with the company were to be handled out of court in arbitration. Lopez electronically signed the agreement and acknowledged his receipt of the agreement. In January of 2015, one month after his 18th birthday, Lopez filed a class action complaint against Kmart alleging violations of California wage and hour laws. Kmart filed a motion to compel arbitration. Lopez contended that, because he was a minor when he acknowledged the agreement, he is now entitled to disaffirm the agreement and render it void, thus allowing Lopez to pursue his claim in court. QUESTION: Did Lopez have the right to disaffirm the agreement due to him being a minor when he signed it? REASONING: To begin the case, the district court found that the arbitration agreement was indeed valid but acknowledged that this fact hardly mattered if Lopez had the right to disaffirm the agreement. The court had to find whether Lopez was entitled to disaffirm the arbitration agreement or if he even had the capacity to enter into the agreement at all as a minor. The court found that the California

Family Code clearly provides that a minor has the capacity to contract, and that “[e]xcept as otherwise provided by statute, a contract of a minor may be disaffirmed by the minor before majority [age 18] or within a reasonable time afterwards[.]” Lopez claimed disaffirmance within a month of reaching the age of majority, which the court found to be a reasonable period of time. The court also cited Fife v. Facebook, a case that found that disaffirmance of a contract by a minor rescinds the entire contract, rendering it void. The court also noted that the California Family Code does specifically exclude certain types of contracts from disaffirmance, such as contracts for necessaries for the minor or the minor’s family, and ruled that Lopez’s contract with Kmart is not one of those types of contracts. DECISION: Lopez had the right to disaffirm the agreement and did so in a timely manner, rendering the agreement void. Kmart’s movement to compel arbitration was denied and Lopez was free to pursue his class action claim in court. SIGNIFICANCE: This case demonstrates the power a minor has to disaffirm any contracts he or she enters into and may serve as a caution to those entering into contracts with minors. CRITICAL THINKING Kmart’s attorneys argued unsuccessfully that by allowing the minor to disaffirm the employment, the court was discouraging employers from hiring minors in the future. Do you think the court should have given more weight to this argument? ETHICAL DECISION MAKING What values were in conflict when the court made this decision? GLOBAL Context Flag Illustrations/Alamy Stock Photo Capacity of a Minor in Iran United States law allows minors to void certain contracts. The mentality behind this law is that individuals below a certain age cannot be entirely accountable for their decision. The age of majority in Iran is 15 for males and 9 for females. Iranian law distinguishes between two classes of minors, “discriminate” and “nondiscriminate,” each with different capacities to contract. Discriminate minors are those old enough to understand their pecuniary interests to some extent and can distinguish between right and wrong but cannot carry out their financial affairs independently. Contracts made by “discriminate” minors are not void but do not become valid and enforceable unless later validated by the minor’s parent or guardian. Nondiscriminate minors are those too young to properly understand their own interests, and any contract they enter into is immediately null and void. Whether a minor is discriminate or nondiscriminate is determined by a magistrate based on the child’s perceived competence. Typically, a minor is considered discriminate around the age of six or seven. Source: Parviz Bagheri et al., “Parties’ legal capacity in electronic commerce transactions,” 44 Eur. J. Law Econ. 503 (2017). The obligations of the minor on disaffirmance vary from state to state.

Traditionally, most states simply required the minor to notify the competent party of the intent to disaffirm and return to the competent party any consideration received under the contract that was still under the minor's control, regardless of the condition of the consideration. If the consideration has been destroyed or damaged, the minor returns whatever is left of it, and the other party has no recourse against the minor under most circumstances. For instance, if William, a minor, purchased a stereo receiver from Sound Systems, Inc., under a six-month contract and dropped it a week after he took it home, he could return it to the store in its broken condition and tell the owner that he wished to rescind the contract. He would be entitled to the return of his down payment and would owe no further obligations to the store. Page 240 Such a rule makes sense if you view minors as innocents in need of protection from competent adults who would otherwise take advantage of minors. However, the rule does not encourage competent parties to enter into contracts with minors, and some observers argue that it allows a knowledgeable and unethical minor to take advantage of a competent party. Consequently, a number of states have modified the duty of the minor on disaffirmance, holding that the minor has a duty of restitution that requires them to place the competent party back in the position that party was in at the time the contract was made. Thus, continuing with the stereo receiver example, in some states, William would have a duty of restoration that would require him to compensate the store owner for the difference between the value of the receiver in the condition it was in when given to William and its value in the condition it was in when returned. The disaffirmance must occur before or within a reasonable time of the minor reaching the age of majority. What constitutes a reasonable time is determined on a case-by-case basis. Exceptions to the Minor's Right to Disaffirm the Contract The minor's right to disaffirm is designed to protect the minor from competent parties that might otherwise take advantage of the minor. But there are certain situations in which, primarily for public policy reasons, either the courts or state legislatures have determined that the minor should not have the right to disaffirm the contract. As a general rule, most states will not allow a minor to disaffirm contracts for life insurance, health insurance, psychological counseling, the performance of duties related to stock and bond transfers and bank accounts, education loan contracts, child support contracts, marriage contracts, and contracts to enlist in the armed services. Most of these exceptions apply in most, but not all, states. Another contractual issue on which the states disagree is the minor's misrepresentation of his or her age. Although the majority rule is that misrepresentation does not affect a minor's right to disaffirm a contract,

some states hold that when a minor who appears to be of the age of majority misrepresents their age and a competent party relies on that misrepresentation in good faith, the minor gives up the right to disaffirm the agreement. One justification for this rule is that any minor who intends to misrepresent his or her age does not need the protection that disaffirmance is designed to provide. Other states have found a compromise between the two extreme positions either by requiring the minor to restore the competent party to that party's precontract position before allowing the disaffirmance or by allowing the minor to disaffirm but then giving the competent party the right to sue the minor in tort and recover damages for fraud. Of course, as the previous paragraphs indicate, the laws created to protect minors from being victimized by competent adults do not necessarily protect competent adults from being taken advantage of by knowledgeable and unethical minors. Thus, individuals operating or working in businesses that are subject to laws requiring their customers to be the age of majority or older must familiarize themselves with the laws pertaining to minors because, often, the responsibility of making sure that a business is dealing with people who are of legal age falls on the employees and the owner. However, because some minors use false identification or misrepresent themselves as adults, it is sometimes difficult for business owners and employees to recognize which customers are truly of age. Page 241 For example, as CEO of Girls Gone Wild (GGW), Joe Francis runs a business that requires him to be familiar with the laws surrounding minors. In fact, Francis has said that GGW has very specific procedures in place to prevent filming underage girls and even teaches its camera crew ways to ensure that the girls the crew is selecting to appear in GGW spring break videos are of age. During the selection procedure, the GGW camera crew is required to check the IDs of girls wanting to be filmed, obtain signed written release forms in which the girls give their consent to be filmed, and videotape the girls' IDs as well as the actual process of signing the release forms. Despite his company's strict policies, Francis found himself in the middle of a heated legal battle in 2003 when seven girls claimed that they were underage when the GGW camera crew filmed them on vacation in Panama City, Florida. Francis fought back, saying that the girls misrepresented themselves, knowingly sought out the GGW crew, and wanted to exploit the company to obtain a monetary settlement. After four years of court proceedings and intense media coverage, Francis reached an undisclosed settlement with the women, who reportedly wanted a total of $70 million. Liability of Minors for Necessaries Contracts for necessaries are sometimes considered an exception to the rule that minors can disaffirm their contracts. Technically, a minor can disaffirm contracts for necessaries;

however, the minor will be held liable for the reasonable value of the necessary. The purpose of this limitation is to ensure that minors can obtain the basic necessities of life when their parents will not provide them. A contract for a necessary is a contract that supplies the minor with the basic necessities of life, generally thought of as food, clothing, shelter, and basic medical services. It is sometimes difficult, however, to determine whether something is in fact a necessary. Some courts define a necessary as what is needed for the minor to maintain his or her standard of living and financial and social status, but this can lead to a problem when an item that may be considered a necessary for a child of upper-income parents might be considered a luxury to a child of lower-income parents. Whether an item is considered a necessary is also related to whether the minor's parents are willing to provide the item in question for the minor. For example, in a recent case, a minor chose to live independently, but her parents kept her bedroom open for her and were willing to have her return home any time. When she chose to return home after having fulfilled only two months of a year-long lease, the court found that the lease for the apartment was not a necessary because her parents had always been willing to provide a home for her.3 LO 11-2 Explain how a contract created when one is a minor may be ratified after one is no longer a minor. Ratification Once a person reaches the age of majority, they may ratify, or legally affirm, contracts made as a minor. Once ratified, the contract is no longer voidable. Ratification may be either express or implied. An express ratification occurs when, after reaching the age of majority, the person states, either orally or in writing, that they intend to be bound by the contract entered into as a minor. For example, when she is 17, Marcy enters into an agreement to purchase an automobile from Sam for 10 monthly payments of $1,000. After making the fifth payment, Marcy turns 18 and decides to move out of state. She emails Sam and tells him not to worry because, even though she is moving, she still intends to make her monthly payments to purchase the car. She has expressly ratified the contract. An implied ratification occurs when the former minor takes some action after reaching the age of majority that is consistent with an intent to ratify the contract. Going back to the previous example, if, the day after she turns 18, Marcy enters into an agreement with Joe to sell him the car in six months, that action is obviously consistent with an intent to finish purchasing the car, so she has impliedly ratified the contract. Most courts find that continuing to act in accordance with the contract, such as continuing to make regular payments under a contract after reaching the age of majority, constitutes ratification. For example, if Marcy continued using the car and making payments on it for several months after reaching the age of majority, the

courts would probably find that she had ratified the contract. Page 242 Parents’ Liability for Their Children’s Contracts, Necessaries, and Torts As a general rule, parents are not liable for the contracts entered into by their minor children. Because of this rule, merchants are often reluctant to enter into contracts with minors unless some competent person is willing to agree to cosign the contract. In that way, the competent person will be legally bound to perform the obligations undertaken by the minor if the minor no longer wishes to live up to the terms of the contract. Parents do, however, have a legal duty to provide their children with the basic necessities of life, such as food, clothing, and shelter. Thus, they may be held liable in some states for the reasonable value of necessaries for which their children enter into contracts. In most states, parents are not liable for the torts of their minor children; minors are liable for their own personal torts. In many states, however, parents may be liable when a child causes harm because the parent failed to supervise the child properly, thereby subjecting others to an unreasonable risk of harm from the child. Mentally Incapacitated Persons Persons suffering from a mental illness or deficiency may have full, limited, or no legal capacity to enter into a binding contract, depending on the nature and extent of their mental deficiency. If a person suffers from mental problems yet still understands the nature of the contract and the obligations imposed by it, the person may enter into a binding, legal agreement. Suppose, for example, that Gina suffers from the delusion that she is a rock star. When an encyclopedia salesperson comes to her door, she buys a set of encyclopedias from him because she believes that it is important for her to be knowledgeable to set a good example for her fans. As long as she understands that she is binding herself through a contract to make monthly payments for two years to pay for the encyclopedias, she is bound to the contract. If, after making a year of payments, she no longer suffers from her delusions and wishes to disaffirm the contract, she will not be able to do so because her delusions did not affect her understanding of what she was legally agreeing to do. However, a person suffering from a mental illness or deficiency that prevents understanding of the nature and obligations of the transaction being entered into has only limited capacity to enter into a contract. If, in the preceding scenario, Gina’s delusions prevented her from understanding that she was signing a contract, and she thought she was giving the salesperson her autograph when she signed the contract, the contract is voidable. She may disaffirm it at any time until a reasonable time after she no longer suffers from the mental deficiency. Once the mental deficiency has been removed, she may also choose to ratify the contract. As with contracts of minors, a contract of a person suffering from a mental

deficiency that is for necessaries can be enforced for the reasonable value of the necessary. A person with mental deficiencies that result in an adjudication of insanity and an appointment of a guardian has no capacity to enter into contracts and any contract attempted is void. Guardians may be appointed not only for those who are adjudicated insane but also for those who are adjudicated habitual drunkards and those whose judgment has been impaired because of a condition such as Alzheimer's. In any case, although the person for whom the guardian has been appointed no longer has the legal capacity to enter into contracts, the guardian has the legal capacity to enter into contracts on that person's behalf. BUT WHAT IF. . . WHAT IF THE FACTS OF THE CASE OPENER WERE DIFFERENT? Let's say in the Case Opener that it was not a child making a purchase but a mentally disabled person named Chloe. Let's say that Chloe was convinced that she owned a dog, even though she didn't, and ordered $1,000 worth of dog food. Which kind of legal capacity would Chloe have? Could she then avoid her contract? What if Chloe had been adjudicated insane and committed to a mental institution but was staying with her sister on a weekend visitation pass when she made the purchase? Page 243 Intoxicated Persons For purposes of determining capacity, intoxicated persons include those under the influence of alcohol or drugs. There is some variation among states in the treatment of the capacity of intoxicated persons to enter into contracts. As a general rule, most states follow the Restatement of Contracts, Section 16, which provides that contracts of an intoxicated person are voidable by the intoxicated person if the other party had reason to know that because of the intoxicated person's condition, that person was unable to understand the nature and consequences of the transaction or was unable to act in a reasonable manner in relation to the transaction. If the intoxication merely causes someone to exercise poor judgment, the person's capacity to enter into a legally binding contract is not affected. Likewise, if one party has no way of knowing that the other was intoxicated at the time the agreement was made, and the agreement is a fair one, it will be upheld by most courts. For example, Lisa emails Rob and offers to buy his antique car from him for $8,000. Rob has just broken up with his girlfriend and has been drinking nonstop all day. He gets the email message and immediately responds in the affirmative. Lisa had no way of knowing Rob was intoxicated, so they would have a valid contract in most states. Once sober, the intoxicant has the ability either to ratify or disaffirm the contract. Because public policy does not favor intoxication, the courts tend to be unsympathetic to intoxicants and will fairly liberally interpret behavior that seems like ratification as ratifying the contract. If Jim became intoxicated at a bar one evening, and Randi took

advantage of the situation by getting him to sign a contract to sell her his 2004 SUV for $8,000, any act Jim takes consistent with ratification after becoming sober will result in a binding contract. If Randi appears at his house the next morning with the cash, shows him the contract drafted on a napkin that he signed, and asks for the keys and the title, then by giving her the keys and saying, “I knew I shouldn’t have drunk that much,” Jim has entered into a binding contract. If the contract is disaffirmed on the basis of intoxication, each party to the contract must return the other to the condition they were in at the time the contract was entered into. Also, as with contracts of persons who have limited capacity, a contract of an intoxicated person for necessaries will be enforced for the reasonable value of the necessaries. Exhibit 11-1The Three I’s of Incapacity: General Rules TYPE OF INCAPACITY CONSIDERATIONS IF THE ANSWER IS YES, THE GENERAL RULE IS: Infancy Is the person under the age of majority (a minor)? The contract is voidable. Insanity Is the person suffering from mental deficiencies that prevent them from understanding their legal obligations under the contract they are entering into? The contract is voidable. Does the person’s mental deficiency simply impair their judgment about the desirability of the contract but not prohibit them from understanding their obligations under it? The contract is valid. Is the person adjudicated insane? The contract is void. Intoxication Is the sober party aware that the intoxicated person is so impaired that he is unable to understand their legal obligations under the contract they are entering into? The contract is voidable. Is the intoxication such that it impairs only the intoxicated person’s judgment but not their understanding of their contractual obligations? The contract is valid. Has the intoxicated person been adjudicated a habitual drunkard? The contract is void.

Legality LO 11-3 List the conditions under which a contract is unenforceable by law. To be enforceable, a contract must have a legal exchange as its subject and must be able to be performed legally. In the event of a contract with an illegal subject, it is the agreement or the bargain that is illegal, not the contract. By definition, contracts are legal. That is why when a contract is overturned due to being contrary to law, the contract is frequently declared void, as if it never existed, as opposed to being declared illegal. It is important to recognize, however, that contracts can be determined illegal even if they are not against a specific statute. When contracts are against

generally accepted public policy, these agreements are determined to be unenforceable, and not void. No remedy is available for unenforceable agreements. Contracts that Violate State or Federal Statutes As previously stated, certain agreements are illegal because either the subject or the performance of the agreement violates a state or federal statute. Given the various state and federal statutes, there are a large number of possible ways in which contracts can violate a statute. Some of the more common ways are discussed below. Agreements to Commit a Crime or Tort Contracts cannot be for an illegal subject or be carried out by illegal means. Therefore, any agreement to commit a crime or tort is illegal and unenforceable. However, if a legal contract is formed and then the subject of the contract becomes illegal under a new statute, the contract is considered discharged by law. For example, Jim agrees to work for Heather for one year as a poker dealer at her casino. After Jim and Heather enter into this employment agreement, the state government passes a law saying that poker may no longer be offered in casinos in the state. Because it would now be illegal for Jim to work as a dealer, the contract is discharged by law. Licensing Statutes All 50 states have statutes requiring people who work in certain professions to obtain a license before practicing their craft. For example, doctors of all varieties, plumbers, cosmetologists, lawyers, electricians, teachers, and stockbrokers are all required to obtain a license before practicing. Although this list of professions is far from exhaustive, it demonstrates how widespread the licensing requirement can be in various states. When licensing is required by law, people in certain fields must obtain a license before they can legally enter into an agreement to perform the restricted services. Frequently, such licenses can be obtained only after extensive schooling or training. The requirement of schooling and licensing demonstrates the concern society places on proper performance of duties in the designated professions. In addition to indicating concern with proper performance, licensing statutes have two main purposes. The first is to give the government an avenue by which to regulate the specific industries. By requiring professionals to obtain a license, the government has some say over who can perform which jobs as well as how many people can perform these jobs. The second main purpose of licensing statutes is more closely related to the public interest. This second purpose is to protect the public’s health, safety, and welfare. By imposing legal standards on a profession, the government is attempting to prevent people from being harmed due to substandard work. For example, surgery is a delicate, complicated process. It is not in the public’s best interest to allow an unqualified person to perform surgery. Therefore, to limit the number of people who might be harmed during surgery, the government

steps in and requires surgeons, even after extensive schooling, to obtain a license. In most states, the purpose of the licensing statute is determinative of whether a contract signed by an unlicensed professional will be enforced or not. If the purpose of the licensing statute is to regulate the number of professionals in the state or generate revenue for the state through licensing fees, a contract with an unlicensed person will still be enforced. Page 245 Conversely, if the licensing statute is intended to protect the public's health, safety, or welfare, the agreement is typically deemed illegal and unenforceable. Licensing statutes can only protect the public if people without the necessary licenses are not allowed to practice these restricted professions. Returning to the example of surgeons, the public is made safer when the government allows only licensed professionals to perform surgery. Therefore, people cannot enter into a contract for professional service with unlicensed professionals when the law requires a license and the statute is intended to protect the public. Case 11-2 illustrates how failure to obtain a license can preclude a party from suing to enforce a contract. CASE 11-2 BAJA PROPERTIES, LLC v. MATTERA 812 SE 2d 358 (2018) FACTS: In September 2013, Ugo Mattera entered into a written construction contract with Baja Properties, LLC. Stephen Chad Golden, the sole owner of Baja Properties, signed the contract and addendums on Baja Properties' behalf. Pursuant to the contract, Baja Properties agreed to build a house for Ugo Mattera on land he and Kellie Mattera owned. Baja Properties completed some of the construction, but disputes developed and Ugo Mattera terminated the contract before the house was completed. Stephen Golden did not have a Georgia builder's or contractor's license when the parties entered into the contract or when the work was performed. The Matteras moved for summary judgment on Baja Properties' claims against them, asserting that OCGA § 43-41-17 (b) bars an unlicensed contractor from enforcing in law or equity a contract for the performance of work for which a license is required. The trial court granted the Matteras' motion for summary judgment on all of Baja Properties' claims, finding that the claims were barred by OCGA § 43-41-17 (b). Baja Properties appealed. ISSUE: Is Baja Properties' right to sue barred by statute? REASONING: OCGA § 43-41-17 (a) provides, in pertinent part, that no person shall have the right to engage in the business of residential or general contracting without a current valid contractor license. OCGA § 43-41-17 (b) provides, in pertinent part, that a contract for the performance of work between an owner and a contractor without a valid contractor license shall be unenforceable by the unlicensed contractor. It is undisputed that Baja Properties and the Goldens did not have Georgia contractor's licenses when the construction contract was executed

and when the work was performed pursuant to the contract. The construction contract clearly identifies Baja Properties as the “Contractor” and Ugo Mattera as the “Owner” of the land on which the construction was to be completed. Thus, under OCGA § 42-41-17 (b), the construction contract is not enforceable by Baja Properties in law or in equity unless an exemption applies. Baja Properties argued that it is exempted from OCGA § 43-41-17 (b) by another provision that allows an owner performing construction on his own property to act without a license. Baja Properties posits that because this provision permits a property owner to act as his own contractor and to use unlicensed contractors, the construction contract at the center of this dispute is “otherwise exempted” from the unenforceability provision of subsection (b). The court held, however, that this provision does not provide that an unlicensed contractor is exempt from the rule that prohibits an unlicensed contractor from enforcing an agreement for the performance of work for which a license is required. The rule was clearly meant to protect owners doing the contracting work themselves as opposed to contractors operating without a license. DECISION AND REMEDY: The motion for summary judgment denying Baja Properties’ counterclaim is affirmed with respect to Baja’s claim for compensation for work done under the contract. SIGNIFICANCE OF THE CASE: This case illustrates the impact that not having a license can have on the enforceability of a contract. CRITICAL THINKING When a judge or judicial panel makes a decision, it must do so on the basis of the information available to it. What is an illustration of a fact that, were it true, might have led to a different outcome in this case? ETHICAL DECISION MAKING The statute spelling out the need for a contractor’s license to perform construction work had an exemption allowing a person to perform construction on their own property without such a license. What stakeholders are being especially advantaged and disadvantaged by the exemption? While most states use the purpose of the licensing statute as the primary determiner of whether to enforce a contract entered into by an unlicensed professional, a few states are more restrictive and will not enforce any contracts entered by an unlicensed party to be enforced. Therefore, it is prudent to check the state law in any situation in which the enforcement of a contract by an unlicensed party. Nonetheless, because the professional is in violation of the law, they are usually required to pay a fine for working without the necessary license. Page 246 While most states use the purpose of the licensing statute as the primary determiner whether to enforce a contract entered into by an unlicensed professional, a few states are more restrictive and will not enforce any contracts entered by an unlicensed party to be enforced. Therefore, it is prudent to check the state law in any situation

in which the enforcement of a contract by an unlicensed party may be an issue. Usury Almost as widespread as licensing statutes, statutes prohibiting usury exist in nearly every state. Usury occurs when a party gives a loan at an interest rate exceeding the legal maximum. The legal maximum interest rate varies from state to state, but it is easy to determine the rate in any given state. Although usury statutes act as a ceiling in terms of setting a maximum possible rate, there are a few legal exceptions whereby loans may exceed the predetermined maximum. One exception relates to corporate loans. Most states with usury statutes allow corporations to lend and borrow at rates exceeding the maximum. The rationale behind the corporation exception is that if a business needs money to expand and is willing to pay the higher interest rate, the corporation should be afforded the opportunity to borrow. The converse is that if a corporation is willing to borrow at a high interest rate, parties should be allowed to lend at that rate for corporations only. The intent is to facilitate business transactions to keep the economy in a healthy state. Another exception to usury statutes applies to smaller loans. Many states allow parties to make small loans at rates above the maximum to parties that cannot obtain a needed loan at the statutory maximum. The belief is that if people need money and the statutory maximum is not inducing people to lend, certain parties will make the necessary loans at a higher rate as long as the loan is small, which is defined however the state chooses to define it. This exception is the principle that allows cash advancement institutions to operate. If there is no exception that allows a usurious loan, the legal outcome varies by state. A minority of states declare all usurious loans void, which means the lending party is not entitled to recover either the interest or the principal. A larger number of states allows lenders to recover the principal amount they loaned, but these parties cannot collect any interest on the loan. In addition, a final group of states allows lenders to recover the principal as well as an amount of interest up to, but not exceeding, the statutory maximum. In essence, these states allow the lenders to recover all but the excess interest, as if the loan were given at the statutory maximum rate. Gambling As with licensing statutes, all states engage in at least some regulation of gambling. In this chapter, the term gambling refers to agreements in which parties pay consideration (money placed during bets) for the chance, or opportunity, to obtain an amount of money or property. Although gambling is still illegal in the vast majority of states, many states allow casino gambling. The states most notable for casino gambling are Nevada, New Jersey, and Louisiana. Some states allow certain other types of gambling, either intentionally or through legal loopholes. For example, given California’s definition of gambling, betting on

draw poker is legal. Some states make other exceptions, such as for horse tracks, casinos located on Native American reservations, or legal state-run lotteries. E-Commerce and the Law Observing Sabbath Days Online Sabbath days stem from the religious traditions that were so widespread in America's early days. Among the religions that still observe Sabbath days today is Judaism, which has very strict laws in relation to refraining from conducting business on the Sabbath. This prohibition even extends to the online realm. Not only are those of the Jewish faith told to abstain from conducting online transactions on the day of the Sabbath, but they are also prohibited from making transactions online even if the individual in question has no awareness of it. For example, if an individual schedules to pay for an item when it ships, and the item happens to be shipped on the day of the Sabbath, that individual is considered to have broken Sabbath law. Laws against conducting certain types of business are still active even today, though they may not be rigidly enforced. Source: Rabbi Harvey Belovski, "Must Your Online Shop Shut On Shabbat?" Belogski.blogspot.com, March 6, 2008. Page 247 Sabbath Laws A large number of states still have what are known as Sabbath, Sunday, or blue laws on the books. Sabbath laws limit the types of business activities in which parties can legally engage on Sundays. In most states with Sabbath law restrictions, these laws date back to colonial times. In fact, the term blue law is a reference to the blue paper on which New Haven, Connecticut, printed its Sabbath laws in 1781. New Haven's 1781 law prohibited shops from being open and prohibited all work on the "Lord's day" (Sunday). The activities restricted today by Sabbath laws vary from state to state. Most Sabbath laws pertain to the sale of alcoholic beverages. These laws tend to prohibit the sale of all alcohol or at least specific types either all day or at restricted times on Sundays. Some Sabbath laws go as far as to make it illegal to enter into any contractual relationship on a Sunday. However, an executed, or fully performed, contract created on a Sunday cannot be rescinded. There are exceptions to Sabbath laws. Most states with Sabbath laws allow the performance of charity work on Sundays. In addition, Sabbath laws do not typically apply to contracts involving procurement of necessities, typically defined as prescription medication, food, or anything else related to health or survival. Regardless of how widespread Sabbath laws are, the vast majority of states do not enforce all, or at least some, of their Sabbath laws. In fact, some Sabbath laws have in the past been deemed unconstitutional according to the First Amendment. Nevertheless, if Sabbath laws are on the books, despite convention to the contrary, they can be applied, and some states do apply such laws. As a businessperson, you should always find out whether Sabbath laws exist and,

if they do, whether authorities enforce these laws. Agreements that Violate Public Policy Unlike agreements that are precluded by statute, some types of agreements are not illegal per se, because they are not in violation of any statute or legal code, but are unenforceable because courts have deemed them to be against commonly held public policy. Public policy involves both the government's concern for its citizens and the beliefs people hold regarding the proper subject of business transactions. The focus is on what is in society's best interest. Contracts in Restraint of Trade It is a widely held belief in economics, as well as in America in general, that competition drives down prices, which is good for consumers. Accordingly, agreements that restrain trade are viewed as being harmful to consumers and thus against public policy. These restraints on trade are also known as anticompetitive agreements. Not only are anticompetitive agreements against public policy, they also frequently violate antitrust laws. There is an exception that allows specific types of restraints on trade. When a restraint on trade is reasonable, as determined by the courts, and the restraint is part of a subordinate, or ancillary, clause, the restraint is typically allowed. Such restraints are known as covenants not to compete, or restrictive covenants. Covenants not to compete tend to come in two varieties. The first involves noncompetition in the sale of an ongoing business, and the second involves noncompetition in employment, both of which are discussed below. Page 248 The first category of permissible restraints on trade is covenants not to compete that involve the sale of an ongoing business. Ongoing refers to the status of the business being sold: The business is still running and will still run on its own; it is not being merged and is not closing down. The public policy argument in favor of supporting restrictions with the sale of a business involves the fairness of the sale. Let us examine a hypothetical situation to see why this restraint on trade is allowed. Suppose you purchase a jewelry store from Ann Smith. Ann is a well-respected member of the community, and her business has been around for many years. The people in the community know the store, and they trust Ann to provide fair exchanges. As a well-informed businessperson, you know about Ann's reputation. In fact, her good reputation made the purchase more appealing. Now suppose Ann turns around and opens another jewelry store a block away one month later. Ann's loyal customers are likely to go to her new store because they still trust her. In the meantime, Ann's good name is no longer associated with your store, and your business suffers accordingly. You entered into the sales agreement thinking you would benefit from Ann's good name, but in the end you overpaid for a business that lacks the benefit of Ann's name because Ann took her name with her when she went into competition with your store. In the interest of self-proclaimed

fairness, courts are willing to impose restrictions preventing Ann, or others in her position, from going into immediate competition with you or others in your position. Public policy requests fairness in business transactions, and this fairness does not occur when people profit from a business transaction and then start a new business that destroys the business they just sold. Consequently, the restraints to trade being discussed with the sale of an ongoing business involve the seller's ability to open up another business within a certain geographic location within a designated time period. As previously mentioned, to be enforceable, a covenant not to compete needs to be in a subordinate clause in the contract. If the covenant not to compete is part of the main agreement, and therefore not subordinate, the agreement is typically considered unenforceable and void because it goes against public policy by providing unreasonable restraints to trade. The unreasonableness arises because when the covenant is an integral part of the contract, it cannot be objected to. In contrast, when the covenant is subordinate, the specific noncompetition clause can be removed and the agreement can go forward as planned. The second category of permissible restraints on trade is covenants not to compete that involve employment contracts. The covenants in employment contracts are similar to those in sales contracts. However, with employment, employees are agreeing that if they leave they will not compete with their boss for a designated period of time within a designated geographic area. Covenants not to compete in employment contracts are legal in most states. However, to be legal, the covenant needs to protect a legitimate business interest. Furthermore, the covenant needs to be for a reasonable period of time and geographic area so that it does not unlawfully impinge on the employee's right to earn a living. The agreement must not be for a longer period of time or larger geographic region than is necessary to protect the employer's legitimate business interest. Given the variations from state to state in other areas of the law, it should come as no surprise that the enforceability of covenants not to compete also varies from state to state. For example, California does not allow any covenants not to compete. On a different note, Texas requires the employee to gain a specific benefit from a contract, beyond employment, before its courts will enforce a covenant not to compete. The employee must be given, or gain, something even if the covenant not to compete is for a reasonable period of time and geographic region. LO 11-4 Describe instances in which unfairness affects a contract's enforceability. Unconscionable Contracts or Clauses When courts are asked to review contracts, fairness is not usually high on the courts' lists of things for which to look. Instead, courts typically assume that the contracting parties are intelligent, responsible adults. The belief is, barring

proof of coercion, that parties enter into contracts because they want to do so. Nevertheless, there are times when agreements are so one-sided, or heavy-handed against one party, that the courts will not make the harmed, innocent person fulfill his or her contractual duties. These heavily one-sided agreements are known as unconscionable agreements. The term unconscionable refers to the fact that the agreement in question is so unfair that it is void of conscience. Page 249 Rules against unconscionable contracts exist in both the Restatement (Second) of Contracts and the Uniform Commercial Code. However, before the Restatement and the UCC existed, the common law would not enforce contracts the courts deemed too unfair, or unconscionable. Now, UCC Section 2-302 states: (1) If the court as a matter of law finds the contract or any clause of the contract to have been unconscionable at the time it was made, the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the clause, or it may so limit the application of any unconscionable clause as to avoid any unconscionable result; (2) When it is claimed or appears to the court that the contract or any clause thereof may be unconscionable, the parties shall be afforded a reasonable opportunity to present evidence as to its commercial setting, purpose, and effect to aid the court in making the determination. Every state, with the exceptions of California and Louisiana, has incorporated the preceding UCC section into its state's UCC. Section 208 of the Restatement also incorporates this section from the UCC. There are two main types of unconscionable agreements, procedural and substantive. Procedural unconscionability relates to conditions that would impair one party's understanding of a contract and to the integration of terms into a contract. Regarding impaired understanding of contractual terms, the factors can be anything from tiny, hard-to-read print on the back of an agreement to excessive use of legalese (unnecessarily technical legal language) or even the inability of a person to read over a contract fully and ask any questions before he or she was required to sign. Most frequently, procedural unconscionability arises when one party presents the other with an adhesion contract. An adhesion contract is a contract created by a party to an agreement that is presented to the other party on a take-it-or-leave-it basis. That is, the contract is presented as complete and as the only chance the presented party (known as the adhering party) will have to enter into the agreement. Although adhesion contracts are themselves legal, the presence of one does raise some potential problem indicators for courts. Given that adhesion contracts usually do not allow for debate regarding the agreement, courts tend to examine adhesion contracts to see whether they can determine how voluntary the agreement really was. Conversely, substantive

unconscionability involves overly harsh or lopsided substance in an agreement. That is, if an agreement is terribly one-sided, it is probably invalid on the basis of substantive notions of fairness and fair dealing. Courts would find the following, for example, to be substantively unconscionable: high differences between cost and price in a sales agreement; agreements in which one party gains vastly more than the other; agreements in which one party is prevented from having any sort of equal benefit; agreements in which one party has little to no legal recourse, according to the agreement; and portions of an agreement that are completely unrelated to anything having to do with either party's business risk. Exculpatory Clauses An exculpatory clause is a statement releasing one of the parties to an agreement from all liability, regardless of who is at fault or what the injury suffered is. Because tort law attempts to return the wronged party to the state they were in before the wrong occurred, anything preventing this corrective mechanism is against public policy. It does not benefit society to allow some parties to get away with not having to pay for wrongs they commit simply because they state they will not be liable in various contracts. In fact, the patently unfair nature of an exculpatory clause is closely tied to the idea of unconscionable contracts. Exculpatory clauses frequently show up in rental agreements for commercial or residential property. These clauses are often found to be against public policy. The reasoning is that sometimes people are injured while on property they are renting from another, and sometimes the injuries are due to the carelessness, negligence, or other wrongdoings of the owner. Once again, it does not serve the public's interest to allow landlords, especially when it comes to residential property, simply to disavow all liabilities in advance. If they were allowed to do so, landlords would not be required to fix problems in their rental units, including potentially lethal problems such as faulty electric wiring or lead-based paint. Page 250 A basic test to determine whether an exculpatory clause is unenforceable is to see whether the enforcing party engages in a business directly related to the public interest. Examples of such businesses include banks, transportation providers, and public utilities. Courts believe it is against the public interest to release businesses engaging in work in the public's interest from accountability to the public they are serving. Another concern with large businesses that are serving the public interest is the unfair bargaining power they can possess in negotiating a contract. Given the power these businesses have, they could simply demand that all customers must accept the exculpatory clause, thus escaping all possible liability. Although the idea of these businesses not being liable is bad, what is worse is that there would be no punitive financial motive for them to conduct

their business operations carefully, or so the argument goes. As a result, the potential for increased accidents would be large. Obviously, it is not in the public's interest to have unsafe businesses that are not accountable to the public. Thus, these businesses cannot enforce exculpatory clauses. It is often difficult to know when a court is going to find that an exculpatory clause exists. Case 11-3 details a situation in which the court found that an illegal exculpatory clause did not exist. CASE 11-3 RILEY AND v. STONE GATE Court of Appeals of Washington, Division 2 395 P.3d 1059 (2017) FACTS: Larry Riley formed a rental agreement for a self-storage unit with Iron Gate Self Storage in December 2003. The agreement stated that a maximum of $5,000 of personal property could be stored in the unit and that Iron Gate could only be held liable for up to $5,000. Despite that known limit on liability, at times Riley had more than $1.5 million worth of property stored in his unit. Over the course of the lease, Riley fell behind on payments. From May 2010 to July 2010, Iron Gate sent Riley three past-due notices. In July, Iron Gate sent Riley a notice of auction and the auction occurred seven days later. A bidder paid $2,000 for the contents of Riley's storage unit. Although Iron Gate believed it acted lawfully, Washington state law requires a fourteen day waiting period after the notice before the auction can be held. Two days after the auction, Riley sent Iron Gate a letter asserting that the notice was invalid and the auction should not have occurred. Iron Gate recovered many of the sold auction items by repurchasing them and held them in a storage unit free of charge until Riley retrieved them. However, Riley filed a complaint claiming Iron Gate had violated the Storage Act and the CPA and alleging $1.5 million in damages. Iron Gate believed its liability should be limited to the $5,000 in their limitation of liability clause. ISSUE: Was clause limiting the liability of Iron Gate to $5,000 an illegal exculpatory clause? REASONING: To determine whether Iron Gate's exculpatory clause violated public policy, the court considered six criteria: (1) whether the agreement concerns a situation generally suitable for public regulation; (2) whether Iron Gate performs a service that is of great importance or necessity to the public; (3) whether Iron Gate holds itself out as willing to perform its services for any member of the public who seeks it; (4) whether Iron Gate possesses a decisive advantage in bargaining power over a member of the public who seeks its services; (5) in exercising its superior bargaining power, Iron Gate effectively forces people seeking its services into agreeing to the exculpatory clause; and (6) whether the property of people seeking such services must be placed under control of Iron Gate. The court compared the facts of the case to each criterion. First, Iron Gate is in the self-storage industry, which is in fact a highly regulated industry. Iron Gate is subject to numerous requirements

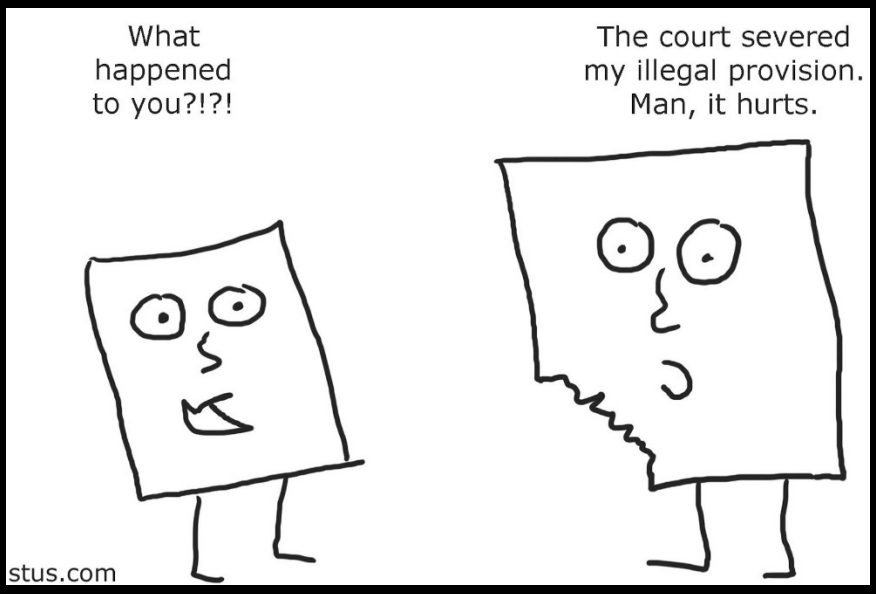
contained within the Storage Act. Second, Iron Gate's self-storage services are not an essential public service. Third, Iron Gate advertises itself to the general public as willing to rent units to any person who seeks it. Fourth, Iron Gate does not have a advantage in bargaining power because Riley had the freedom to take his business elsewhere if he disagreed with the agreement's provisions. Fifth, Iron Gate did not force Riley into the exculpatory clause. Iron Gate provided Riley with an opportunity to purchase insurance that would cover the entire value of his property, but he chose not to do so. Finally, Riley had exclusive control over his unit and the property within. Riley used his own lock on the unit and Iron Gate was only allowed to enter with written notice, in case of emergency, or if Riley defaulted. In light of the facts, the court concluded that Iron Gate's exculpatory clause did not violate public policy. Per the signed agreement, Iron Gate reasonably believed that the contents of Riley's unit did not exceed $5,000. Thus, Iron Gate is not liable for the $1.5 million in value that the contents of the unit allegedly had. DECISION AND REMEDY: The lower court's finding that the clause did not violate public policy and therefore was not illegal was affirmed in favor of the defendant, and therefore its liability was limited to $5,000. SIGNIFICANCE OF THE CASE: In this case, the court clearly lays out the requirements for an exculpatory clause to violate public policy and explains how the clause in question does not meet these requirements. Thus, this case serves as an excellent illustration of when such a clause is and is not binding. CRITICAL THINKING Consider the sixth item in the test applied by Washington state courts. In this case, the court asserted Riley had exclusive control of his storage unit because he placed his own lock on the unit and "Iron Gate could only enter the unit with written notice, in the case of an emergency, or if Riley defaulted." Do you think the sixth item in the test could be problematic if applied to apartment renters?  ETHICAL DECISION MAKING Examine the actions of each party leading up to this dispute. Who behaved in a blameworthy fashion, and who in a praiseworthy fashion? What facts from the case and what ethical theories or guidelines support your claim? Now consider each party's stance in the legal dispute. Does either one appear more or less ethical, relative to that party's earlier actions? Why or why not? Page 251 Although businesses closely linked to the public interest cannot enforce exculpatory clauses, not all exculpatory clauses are unlawful. To be able to enforce an exculpatory clause, the party seeking enforcement must be a private business or an individual and must not be important to the public interest. Such private businesses or individuals provide nonessential services and thus do not have the same bargaining power as the previously discussed groups, such as banks, utilities, and airlines. Given their lack of

huge bargaining power, it is assumed that private businesses and individuals will enter on relatively equal terms and will voluntarily agree on or decline the final contract. Examples of private businesses that can enforce exculpatory clauses include skiing facilities such as resorts or rental places, private gyms or health clubs, any business offering skydiving or bungee jumping, and amusement parks, to name a few. Because the services provided by all these businesses, as well as others in this category, are not something related to the public interest and not something in which people must engage, these parties are allowed to deny liability if the party with which they are contracting agrees to the exculpatory clause. Just because these parties might be able to enforce an exculpatory clause, however, does not mean the clause is always automatically enforceable. The following Case Nugget looks at an interesting situation involving an exculpatory clause. CASE Nugget Can Parents Enter into Contracts on a Minor's Behalf? Trent Woodman v. Kera LLC Supreme Court of Michigan 486 Mich. 228 (2010) Five-year-old Trent Woodman was injured on his birthday at Bounce Party, an indoor play area operated by Kera LLC. Before Trent began playing at the play area, his father signed a liability waiver including an exculpatory clause on Trent's behalf. Mr. Woodman signed the form as the parent, and Trent's name was printed on the form as "participant," meaning he was the one participating in the activity for which the exculpatory clause was drafted. When Trent broke his leg after jumping off an inflatable slide, Trent's mother, as next friend, filed suit against Kera LLC, on behalf of her son, alleging negligence, gross negligence, and violation of the Michigan Consumer Protection Act (MCPA). Kera LLC filed a motion for summary judgment, claiming that the claims were barred by the exculpatory clause. Michigan common law prevents parents from entering their children into contracts that waive, release, or compromise a minor's claims. Because parents' authority of a minor is limited to the care and custody of the minor, any contract that a parent might enter into on his or her minor's behalf is unenforceable. The Michigan Supreme Court upheld the common law in this case by finding that the waiver that Trent's father signed was unenforceable. The court refused to change common law because it believed that the court lacked the tools to measure the risks involved in such a policy change adequately. Therefore, the better vehicle for changing the common law is through legislature. Trent's case was remanded for further proceedings. Page 252 Effect of Illegal Agreements LO 11-5 Recall the legal effect of entering into a contract for illegal purpose. Generally speaking, when an agreement is deemed illegal, courts will label the contract void. The reason most illegal agreements are void is that, in most cases, both parties are equally responsible for the illegal

agreement. In the law, when both parties are equally responsible for an illegal agreement, the parties are said to be in pari delicto. When both parties are at fault, it does not make sense for the courts to attempt to salvage the agreement or reward either party. Therefore, most illegal agreements are void, meaning neither party can enforce the agreement and neither party is entitled to recovery. However, it is not always the case that both parties are at fault. If one party is not responsible for an illegal agreement, or special circumstances forgive the illegality, it makes sense sometimes to allow one party to an illegal agreement to recover various damages. The first exception to the general rule occurs when a member of a protected class is involved in an agreement that contradicts a statute intended to protect the specific class. In the event of such a contradiction, the member of the protected class is allowed to sue for performance. The reasoning is that if a statute is intended to protect a specific class, people outside the class should not be allowed to use the statute to harm those inside the class. For example, a work agreement between a truck driver and his or her employer may specify that the driver gets paid for the number of hours worked. Yet certain statutes limit the number of hours truck drivers may drive in a given time period. If the truck driver accidentally drives more than the allowable hours, the driver has technically violated a statute. However, this violation does not allow the employer to refuse to pay the driver for the extra hours. Rather, the driver may sue the employer to enforce the work agreement. The second exception to the voiding of illegal agreements occurs when there is a justifiable ignorance of facts. A justifiable ignorance of facts is one party’s lack of knowledge regarding a provision of the agreement that would make it illegal. Although ignorance of the law does not excuse illegal behavior, not knowing that the other party to a contract intended to fulfill the agreement through illegal means does function as an excuse. Page 253 When one of the parties is relatively innocent in the whole deal, the court may give back any consideration that party gave or may require an exchange for partial performance such that both parties can be returned to the positions they were in before they entered into the agreement. Conversely, if one party is completely innocent of any illegality and has completed their portion of the contract, then—depending on the reason the contract is considered illegal and depending on which state’s laws are in question—the court might enforce the entire agreement. A third exception to the general rule occurs when one of the parties withdraws from an illegal agreement. The key to any recovery is that the party must have withdrawn before any illegality occurred. If this is the case and if part or full performance has occurred, the party may recover value for whatever portion

has been completed. However, if the party is involved in any way in the illegal activity, the party cannot recover at all. LO 11-6 Describe the characteristics of a severable contract. Severable Contracts A severable contract, also known as a divisible contract, contains multiple parts that can each be performed separately. In addition, separate consideration is offered for each individual part. In essence, a severable contract is like numerous contracts in one. Conversely, an indivisible contract requires complete performance by both parties, even if it appears as though the contract contains multiple parts, similar to a severable contract. Used by permission of Stu Rees, Stu's Views. With respect to illegality, severable contracts have a huge advantage over indivisible contracts: If a severable contract has both legal and illegal portions, the court has the option of declaring void only those sections of the agreement that are illegal. The court can then enforce the remaining, legal portions of the contract. Indivisible contracts must be enforced or rejected in their entirety. For a court to be able to enforce parts of a severable contract, the parts that are enforced must still represent the main purpose of the original agreement. If declaring parts of a contract void substantially alters the contract, the court is not likely to enforce the remaining portions of the agreement. Courts ultimately want to facilitate business transactions and enforce the legal wishes of parties, and severable contracts enable courts to do so. And, of course, since severable agreements are subject to a court interpreting each section for legality, it is probably unwise to enter into such an agreement when the legality of some sections is questionable. Page 254 CASE OPENER WRAP-UP Apple's Questionable Contract The U.S. District Court for the Northern District of California denied Apple's motion to dismiss the lawsuit. The court stated that the complaint could not be dismissed because no case law was provided to prove that Apple's Terms of Service served as a contract for all subsequent transactions. Apple then constructed a settlement with all the plaintiffs in the class-action lawsuit that had to be court-approved. First, Apple would have to immediately send notices to 23 million customers with iTunes accounts, notifying the customers of parental controls that can block extra purchases. Second, customers in the lawsuit were to receive a $5 credit for use at the iTunes store. Customers whose children spent $30 or more would be entitled to a cash refund instead of credits. Finally, Apple would pay $1.3 million in attorney fees. PRACTICAL TIPS for Business Managers Remember that people don't always look their age, so always make sure to verify the age of anyone with whom you are entering into a contract. You do not want to find out you have entered into a contract with a minor by the minor telling you they want to disaffirm the agreement. There may be times when you need an

exculpatory clause in one of your contracts. To ensure that the exculpatory agreement is enforceable, it is a good idea to make sure the clause is printed in a large font and initialed by both parties. If possible, provide options to the other party, so that the clause is clearly negotiated. When drafting a covenant not to compete in conjunction with the sale of a business, make sure that it is clearly reasonable both in terms of the length of time it is valid for and the geographic area. One way to determine reasonableness of both is to rely on your customer list, both in terms of where your customers live and how frequently they use your services. Because of the value of this information if you should sell your business, it is a good idea to maintain good customer lists because you never know when you may decide to sell.




SUMMARY Capacity Natural persons over the age of majority are presumed to have the full legal capacity to enter into binding, legal contracts. A person has only limited capacity to enter into a legally binding contract if the person is A minor. Suffering from a mental deficiency that prevents the person from understanding the nature and obligations of contracts. Intoxicated. A person has no capacity to enter into a contract if the person Has been adjudicated insane. Has been adjudicated a habitual drunkard. Has had a legal guardian appointed to enter into contracts on his or her behalf. Legality Contracts that do not have a legal object are not valid. Contracts may lack a legal object because they violate a statute or violate public policy. If the illegal portion of

a contract can be severed from the legal portion, the courts may simply refuse to enforce the illegal parts and enforce the remaining legal parts.

Point/Counterpoint Should Minors Have Full Capacity to Enter into Binding Legal Contracts at the Age of 15? YES NO The infancy doctrine, which holds that minors are not developed enough to make fully rational decisions and therefore do not have the capacity to enter into contracts, is not only antiquated but makes faulty assumptions about the minds of minors of certain ages. No one is arguing that a two-year-old toddler has the capacity to make rational business decisions that are in their interests. The capacity of a 16-year-old, however, is a different story. Many developmental psychologists, including the famed Jean Piaget, have found that minors of ages fifteen and up have essentially the same rational capacity as adults and can utilize theoretical, hypothetical, and counterfactual thinking, as well as abstract logic and reasoning. While contract law does not recognize minors as fully rational beings, there are other areas of law that do. For example, many state criminal codes allow minors to be considered adults when being tried for heinous crimes. Approximately 250,000 minors are tried, sentenced, or convicted as adults every year across the United States, and until the Supreme Court effectively outlawed the practice in 2005, states could give minors the death penalty. The law is inconsistent in that it can assume that minors are rational adults when committing a crime, but not when entering into a contract. Another problem with the infancy doctrine is that it assumes that minors will necessarily be the victims of unfair contracts and therefore allows them the ability to disaffirm at will. However, this means that contracts with minors are voidable by the minor, but not void. In other words, the contracts are one-sided in that the minor can enforce them against the other party, but the other party cannot enforce them against the minor. In today’s digital marketplace, where minors are becoming increasingly involved and may even provide content or a service to an adult, the infancy doctrine gives minors an unfair advantage. In fact, it is not unheard of for the minors of this generation to use their tech savvy to prey on unsuspecting consumers. The infancy doctrine in the age of the digital marketplace creates another problem: online, it is almost impossible to truly verify with whom one is doing business. An online businessperson will never truly know whether their online client is a minor or not. This issue creates all sorts of risks for such a businessperson because they have no idea whether any digital-sales contract, for example, is voidable by the other party at any time. The infancy doctrine is founded on questionable assumptions and simply does not work

in today’s world. The infancy doctrine is more important than ever in today’s marketplace. Even though many children have a technological prowess that overshadows that of many adults, children are not immune from abusive contracts and are likely not developed enough to enter into contracts in the first place. Some arguments in favor of doing away with the infancy doctrine cite as a primary reason that some teenagers are cognitively developed enough to be able to rationalize on the same level as adults. Regardless of whether this is true, children and teenagers are more impulsive and lack the experience and foresight to make certain decisions in their favor. In other words, while minors can sometimes rationalize a situation as well as an adult, that does not necessarily mean that they will make as good a decision as an adult would. Thus, minors are more likely to brazenly enter into unfair contracts without having the foresight to think of the long-term consequences of doing so. Another common argument against the infancy doctrine is that minors can abuse their right to disaffirmance and enter into one-sided contracts in their favor. A classic example is one where a minor enters into a sales contract to purchase a car, immediately proceeds to wreck the car, disaffirms the contract, and demands a refund for the car while returning the totaled vehicle. However, many courts have instituted exceptions to the infancy doctrine for situations just like the one described. Often, if a minor reaps some kind of benefit from the contract, they cannot disaffirm the contract without returning that benefit to the other party in full. In the case of the wrecked car, the minor would not be able to disaffirm the contract without returning a car to the seller that was in the same condition in which it was purchased. Those who argue against the infancy doctrine fail to understand the balance of power between corporations and minors. Over the past few decades, minors have become a class of consumer all of their own, and the digital commerce age has brought the market to minors in ways that were inconceivable even at the time when the infancy doctrine first came about. Corporations specifically utilize the inexperience, naiveté, and rash decision-making of minors to finely target their advertisements and sell their products. Is it fair, for example, for a business to enter into a contract with a minor for a credit card with a 20 percent interest rate when that minor has not had the time or experience to develop financial literacy? Businesses target minors because they know minors do not have the same level of education or decision-making skills as adults, and thus minors require the protection that the infancy doctrine provides.

Questions & Problems Why does it matter that a contract with a minor is for a necessary? Explain the obligations of a minor who chooses to disaffirm a contract. Go back to the discussion of contracts that cannot be disaffirmed by minors and explain the policy reasons that support each of the exceptions. Can you make an argument for any additional kinds of contracts that should not be subject to disaffirmance by minors? If all you know about a man is that his neighbors think he is crazy, you do not know whether a contract he entered into was valid, voidable, or void. Why not? What factors determine whether a covenant not to compete is legal or illegal? What is the relationship between contracts in restraint of trade and unconscionable contracts? Steven Sanchez worked as a warehouse employee for Gruma Corporation. In December 2016, Sanchez was presented an arbitration agreement during a meeting with George Tate, the human resources manager for Gruma. According to Sanchez, Tate told him and other workers to sign the agreement and that "whoever did not sign [the agreement] could not have a job." Sanchez alleges that he was not told that he could opt out of the agreement and that he would have done so if he knew. Sanchez further alleges that he was pressured to sign the agreement on the spot without time to read it, which is a claim that Tate disputed. Sanchez was later fired from Gruma in August 2017. Following his termination, Sanchez filed suit against Gruma, alleging claims of unpaid wages, disability discrimination, and wrongful termination, among other claims. Gruma sought to compel arbitration. Sanchez claimed that Gruma was barred from compelling arbitration because the arbitration agreement was unconscionable. What are the two types of unconscionability a court considers when reviewing an allegedly unconscionable contract? Do you think the court agreed with Sanchez that the agreement was unconscionable? Source: Sanchez v. Gruma Corporation, Dist. Court, ND California 2019. Valve Corporation makes and distributes its own games as well as games produced by third-party companies on a platform called Steam. In addition to Steam, Valve hosts a community-driven market called Steam Marketplace where members can buy, sell, and trade digital items such as games and cosmetic effects. Plaintiffs in this case, minor children, who use Steam Marketplace, and their parents, are suing Valve for allegedly supporting "'illegal gambling' by 'allowing millions of Americans, including Plaintiffs, to link their individual Steam accounts to third-party websites' and by 'allowing third-party sites to operate their gambling transactions within Steam marketplace.'" Valve responded by filing a motion to compel arbitration as conspicuously set forth in the Steam Service Agreement that one must accept to set up and use a Steam Account. Recall question 2, where you explained what the obligations

of a minor who chooses to disaffirm a contract are. Do you think the minor plaintiffs in this case can preclude the arbitration clause by disaffirming the agreement? Why or why not? Do you think the arbitration clause in the Steam Service Agreement binds the minor's parents to arbitrate? How do you think the court should rule in this case? Source: GG v. VALVE CORPORATION, Dist. Court, (2017). Christopher Boling was seriously injured in 2008 when vapors escaping from a gas can ignited. He filed a products liability claim against the manufacturer. To fund the litigation, Boling entered into four agreements with Prospect Funding Holdings, LLC, to borrow funds totaling $30,000. Each agreement provided that interest on the principal accrued at a rate of 4.99% per month. In 2014, Boling resolved his suit against the gas can manufacturer. Shortly thereafter, Prospect sent Boling a "Schedule of Purchases" asserting that Boling owed Prospect $340,405. Boling filed suit against Prospect in Kentucky, arguing that the four agreements were void and unenforceable under Kentucky statutes prohibiting usury. Kentucky's statute states, in relevant part, that the maximum permissible per annum rate of interest on a loan was 4% plus the rate of the Federal Reserve Bank in the relevant district or 19%, whichever is less. The Federal Reserve Bank's rate at the time was approximately 1%. Prospect argues that the agreements were not loans, so the usury statute does not apply. Do the math; did Prospect violate Kentucky's statute? How do you think the court ruled on the issue of whether the agree-ments were loans? Source: Boling v. Prospect Funding Holdings, LLC, 2019 WL 1858506 (6th Cir. April 25, 2019). Page 257 In November 2011, Rosemarie Roopchand made a $200,000 loan to Raheek Mohammed. The parties executed a promissory note stating that Mohammed would repay Roopchand the principle sum of $200,000 with interest at the rate of 100 percent for the term of the loan, i.e. 50 percent per year for two years. The note also included a provision where, if Mohammed was unable to make payments, his company, Medina Petroleum Corporation, would make Roopchand whole. Roopchand invariably filed an action against Mohammed, his wife, and Medina Petroleum after Mohammed failed to complete payment on the promissory note. In response, the defendants filed a motion for summary judgment on the ground that the terms of the loan were usurious. The court dismissed the case in favor of the defendants and Roopchand appealed. In its ruling, the appeals court stated that "where a loan agreement is usurious on its face, usurious intent will be implied and usury will be found as a matter of law." What do you think of this criteria? How would you define the limits of "usurious on its face"? In this particular case, the maximum interest rate allowed by the state for a loan was 16 percent. If the interest rate in the

promissory note was 17 percent would it be “usurious on its face”? What about at 18 percent? 20 percent? 25 percent? How would this case be different if the loan had been made directly to Medina Petroleum Corporation? Source: Roopchand v. Mohammed, 154 AD 3d 986 (2017). Rachel Nitka began working at a Chili's restaurant in November 2015. She was 17 years old at the time. In 2018, she filed a suit against Chili's parent company, ERJ, and two coworkers, alleging sexual harassment, sexual discrimination, and assault and battery. In response, ERJ sought to compel arbitration based on an agreement Nitka signed upon being hired in which she agreed to arbitrate all disputes related to her employment. Nitka argued that the arbitration agreement should not be enforced because she does not remember signing the agreement. Additionally, Nitka was a minor when she signed the agreement and now wishes to disavow the agreement. What do you think of Nitka’s arguments? Does the fact that Nitka does not remember signing the agreement mean she cannot be held to it? What about the fact that Nitka was a minor when she allegedly signed the agreement? Can Nitka disavow the agreement now? How should the court rule? Source: Nitka v. ERJ Dining IV, LLC, Case No. 18 cv 3279 (N.D. Illinois 2018).No. 18 cv 3279 (N.D. Illinois 2018).

Part 2 Contract Law CHAPTER 12 Reality of Assent Page 258 CASE OPENER Disagreement Over an Agreement In spring 1989, Michael Jordan and the Chicago Bulls were in Indianapolis, Indiana, to play against the Indiana Pacers. At the same time, Karla Knafel was singing with a band at a hotel in Indianapolis. After Knafel’s performance, a National Basketball Association referee approached her and introduced her to Jordan by telephone. Knafel and Jordan began a long-distance telephone relationship that continued for several months. In December 1989, Knafel traveled to Chicago to meet with Jordan, where the couple had unprotected sex for the first time. In November 1990, the couple had unprotected sex again while in Phoenix, Arizona. Shortly after this second meeting, Knafel learned that she was pregnant. Knafel was convinced that she was “carrying Jordan’s baby” despite having had sex with other male partners. Later, during spring 1991, Knafel informed Jordan she was pregnant with his child. As a result of several conversations about the baby, Knafel alleged that the two had agreed that Jordan would pay her $5 million when he retired from professional basketball. In return, Knafel promised she would not file a paternity suit against him and would

keep their relationship a secret. In July 1991, the baby was born. Jordan paid some hospital bills and medical costs, and he paid Knafel $250,000 for “her mental pain and anguish arising from her relationship with him.” Knafel continued to keep the relationship and paternity a secret. In 2000, after Jordan retired from professional basketball, a lawsuit arose between the parties. Jordan sought declaratory judgment and an injunction against Knafel, who had been approaching him for the $5 million. Knafel filed a counterclaim for Jordan’s alleged breach of contract. The trial court dismissed all claims, but the appellate court remanded Knafel’s claim for breach of contract. Although Jordan had originally denied the existence of the agreement, on remand he did not contest the existence of the alleged settlement agreement. Instead, Jordan argued that the alleged agreement was not enforceable because it either was fraudulently induced or was based on a mutual mistake of fact. In support of his argument, Jordan produced the affidavit of Dr. Storm, who, after DNA testing, concluded that Jordan was not the child’s father. In response to Jordan’s argument, Knafel claimed that the paternity of the child was irrelevant to the enforceability of the alleged agreement. An obstetrician had told Knafel that the baby was conceived on November 19 or 20, 1990 (while she was in Phoenix with Jordan). As a result of this information, Knafel believed that the baby was Jordan’s. Additionally, Knafel asserted that the paternity was irrelevant because Jordan entered into the agreement knowing that she had been having sex with other men. The trial court ruled in favor of Jordan, finding that “as a result of Knafel’s fraudulent misrepresentation to Jordan that he was the child’s father or, alternatively, as a result of a mutual mistake of fact, the alleged settlement contract is voidable and is therefore unenforceable against Jordan.” Knafel appealed. Imagine you are the judge in this case. Do you think that both parties were able to assent to the agreement legally? Under which ethical system, if any, should Knafel be able to recover the $5 million for breach of contract? Page 259 LEARNING OBJECTIVES LO 12-1 Describe the importance of legal assent. LO 12-2 Recall the elements of mistake. LO 12-3 Recall the elements of misrepresentation. LO 12-4 Recall the elements of undue influence. LO 12-5 Recall the elements of duress.

## The Importance of Genuine Assent LO 12-1 Describe the importance of legal assent.

When two people talk to each other in the hope that an exchange will take place, all kinds of things can go wrong. Global business needs dependability. Just imagine what it would be like if “Yes” meant “Maybe!” Deals would be closed only to be reopened again and again. The costs of all

purchases would soar. Businesses would be forced to charge extra to pay for all the extra time they had to spend to finally get to the point when “Yes” really meant “Yes.” To make business transactions smoother and more dependable, the law has developed rules about when “Yes” means “Yes.” As Chapter 9 explained, you need an offer and an acceptance to form a contract. Sometimes, however, there is a problem with the acceptance. Certain problems with the acceptance, or the yes, may give rise to the claim that the acceptance was not really genuine and, therefore, that the resulting contract is not valid. In this chapter, we examine the problems that may arise with an acceptance that will make the resulting contract voidable. When a contract is voidable, it may be rescinded, or canceled. The cancellation of a contract permits the person who canceled it to require the return of everything they gave the other party. At the same time, the person who rescinds the contract must return whatever they have received from the other party. A major theme of this chapter is that good business managers aim for genuine assent in their contracts. This chapter shows you how to achieve genuine assent. It explains the major obstacles to genuine assent: mistake, misrepresentation, undue influence, and duress. Knowing about these potential problems will help you avoid them.

Mistake LO 12-2 Recall the elements of mistake. When people agree to buy or sell, they do so with a particular understanding about the nature of the good or service they are about to exchange. However, one or both parties may think they consented to exchange a particular thing only to find out later that no meeting of the minds had occurred. People may misunderstand either some fact about the deal or the value of what is being exchanged. We focus on misunderstandings about facts because they are the only issues that raise the potential of rescission in American courts. Page 260 European courts take a different approach to mistakes about the value of performance of a contract. In general, they agree with the reluctance of American courts to interfere with a contract just because the value of the item in question has changed since the agreement. The parties are assumed to have accepted the risk, when they made the contract, that the value might change later. However, European courts permit rescission of the contract for a mistake of value when the mistake involves more than 50 percent of the value at the time of the contract. Legal assent is absent when a legal mistake occurs. The term mistake in contract law has a special meaning that deserves special attention because it is not quite the same as the ordinary use of the term. A mistake is an erroneous belief about the facts of a contract at the time the

contract is concluded. There is one more important aspect of the definition of mistake. Later in this chapter, when we discuss misrepresentation, our focus will be on incorrect beliefs about the facts of the contract caused by the other party's untrue statements. Mistakes in contract law do not result from the untrue statements of the other party to the contract. Mistakes may be unilateral, the result of an error by one party about a material fact, that is, a fact that is important in the context of the particular contract. Alternatively, they may be mutual, shared by both parties to the agreement. This distinction is important in determining which contracts are voidable. Used by permission of Stu Rees, Stu's Views. Unilateral Mistake In general, a unilateral mistake does not void a contract. Courts are hesitant to interfere with a contract when one of the parties has a correct understanding of the material facts of the agreement. For instance, a widow seeking to rescind her and her husband's election to have his retirement benefits paid out over his life was not permitted to receive survivor's pension benefits. The court held that representatives of the retirement system had provided sufficient information to the plaintiff and her husband before they elected that particular form of payout.1 Page 261 Sometimes, however, rescission is permitted for even unilateral mistakes. Because our economic well-being depends so heavily on reliable contracts, we want to be fully aware of the circumstances under which unilateral mistakes permit rescission. Any of the following conditions would permit a court to invalidate a contract on grounds of unilateral mistake: One party made a mistake about a material fact and the other party either knew or had reason to know about the mistake. The mistake was caused by a clerical error that did not result from gross negligence. The mistake was so serious that the contract is unconscionable, that is, so unreasonable that it is outrageous. These situations are rare, but it is important to be aware of them because any rescission can be costly in terms of time and lost opportunities. Mutual Mistake When both parties to a contract are mistaken about either a current or a past material fact, either party can choose to rescind the contract. Rescinding such a contract is fair because any agreement between the parties was an illusion: An ambiguity in some key fact prevented the parties from being in actual agreement. The famous story of the ship Peerless2 has taught generations of students the importance of being very clear in defining material facts in any contract. The parties to the contract that led to the contract disagreement had agreed that the vessel Peerless would deliver the cotton they were exchanging. Unfortunately for them, there were two ships named Peerless. So when the deal was made, one party had one Peerless in mind while the other meant the second Peerless. The times the ships sailed were materially different, so

the court rescinded the contract. CASE Nugget A Questionable Mistake Mary W. Scott (Respondent-Appellant) v. Mid-Carolina Homes, Inc. (Appellant-Respondent) Court of Appeals of South Carolina 293 S.C. 191 (1987) Mary Scott signed a contract to purchase a repossessed 1984 mobile home from Mid-Carolina Homes Inc. for $5,644, to be paid in full before delivery. She gave the salesperson a check for $2,913.71 and agreed to pay the balance before the end of the month. Within the next week, the salesman called and told her he could not sell her the home because it had a bent frame, and the South Carolina Manufactured Housing Board would not permit him to sell a home with a bent frame. She offered to buy it as-is and sign a waiver, but the salesman said that would not be legal. A few weeks later, Mid-Carolina sold the mobile home to another couple for $9,220. Scott sued and was awarded $3,600 actual damages and $6,400 punitive damages for breach of contract accompanied by a fraudulent act and $3,000 actual damages for violation of a state consumer protection law. The appeals court upheld the award. On appeal, Mid-Carolina argued that it was entitled to rescind the contract because the salesperson was acting under a mistake of fact when he gave Scott the sales price. In upholding the award, the state supreme court explained that a contract may be rescinded for unilateral mistake only when the mistake has been induced by fraud, deceit, misrepresentation, concealment, or imposition of the party opposed to the rescission, without negligence on the part of the party claiming rescission, or when the mistake is accompanied by very strong and extraordinary circumstances that would make it a great wrong to enforce the agreement. Mid-Carolina had not demonstrated the presence of any of the circumstances that would justify a rescission. The salesperson was in the superior bargaining position to know the price, and the buyer’s reliance on a salesperson’s representation of the price was reasonable. Page 262 Warning: Anticipate ambiguity in the material facts and clarify them in advance to save yourself headaches later. For a mutual mistake to interfere with legal consent, it must involve all the following: A basic assumption about the subject matter of the contract. A material effect on the agreement. An adverse effect on a party that did not agree to bear the risk of mistake at the time of the agreement. Courts will not void contracts for reason of mutual mistake if even one of the preceding attributes is missing. For instance, to rise to the level of a basic assumption, the mistake would need to be about the existence, quality, or quantity of the items to be exchanged. To meet the second condition, the mistake must involve the essence of the agreement. A fact is material when it provides a basis for a person’s agreement to enter into the contract. In the case opener, Knafel was basing her appeal on the argument that the paternity of her baby

was not material to Jordan’s decision to enter into the contract. Do you think she has a good argument? The second element is not satisfied when the person attempting to avoid the contract simply claims that the item to be exchanged is not the one they had intended to exchange. The third condition is necessary to protect those who bargain with someone who agreed, at the time of the agreement, to bear the risk of mistake but then later wants to avoid that risk when the contract does not work out as well as he or she had planned. This situation might arise, for instance, if the adversely affected party had agreed in the contract to accept the items as-is but later felt they were not worth the price paid. Sometimes, however, one party does not explicitly bear the risk of a mistake but rather does so implicitly by “conscious ignorance” of facts relevant to the alleged mutual mistake. This situation is illustrated in Case 12-1. CASE 12-1 JEROME M. EISENBERG, INC. v. HALL 147 A.D. 3d 602 (2017) FACTS: Jerome M. Eisenberg is an antiquities dealer and a self-proclaimed expert in classical antiquities with a doctorate in Roman, Egyptian, and Near Eastern art. Maurice E. Hall, Jr. is an art dealer that mainly deals in sixteenth to nineteenth century art. Hall asserts that his expertise is in Renaissance art and that he is merely an “amateur collector” of classical antiquities. In 2009, Eisenberg visited Hall’s townhouse, out of which Hall operated his business, and purchased two items: a mar-ble bust of Faustina II, purported to be ancient Roman, and a bronze warrior statue purported to be Etruscan or Roman era. A few months later, Eisenberg sold the bust to the Mougins Museum of Classical Art in France. In April 2011, Eisenberg submitted the bronze statue to a lab in France for metallographic analysis. The lab determined that the statue was from the nineteenth or twentieth century, and there-fore not ancient. In September 2011, the Mougins Museum informed Eisenberg that the bust was a fake in that it was modern and not ancient. Eisenberg filed suit against Hall, claiming the contract should be voided due to mutual mis-take. The trial court ruled in favor of Hall, and Eisenburg appealed. ISSUE: Should the contract between Eisenburg and Hall be voided on summary judgment under the theory of mutual mistake? REASONING: Plaintiff alleges that due to the “mutual mistake” of the parties regarding whether the items were ancient, it is entitled to summary judgment. The court ultimately held that plaintiff is not entitled to summary judgment on its breach of contract claim pursuant to the doctrine of mutual mistake. Although the record reflects that both plaintiff and defendants mistakenly assumed at the time of the transactions that the items at issue were ancient, issues of fact exist as to whether plaintiff bore the risk of that mistake due to its “[c]onscious ignorance” of the items’ authenticity. The court held that the doctrine of mutual mistake “may not be

invoked by a party to avoid the consequences of its own negligence.” Where a party “in the exercise of ordinary care, should have known or could easily have ascertained” the relevant fact—here, whether the items were ancient—that party is deemed to have been “[c]onscious[ly] ignoran[t]” and barred from seeking rescission or other damages. The conscious ignorance exception applies only where a party is aware that his knowledge is limited but decides to contract anyway “in the hope that the facts accord with his wishes,” thus assuming “[t]he risk of the existence of the doubtful fact . . . as one of the elements of the bargain.” The court held that both plaintiff and defendants shared the mistaken belief that the Faustina Bust and the Etruscan Warrior were “ancient.” But the court also found that the record at this time does not support a finding that Eisenberg did not consciously ignore his uncertainty as to a crucial fact. Questions exist as to whether Eisenberg genuinely believed the bust and statue to be ancient, or was aware that they might not be ancient but decided to assume this risk. Hall presented evidence that Eisenberg is an expert on classical antiquities and a qualified appraiser who gener-ally relies on his own expertise in evaluating works unless he is unsure of a piece’s authenticity. He could thus have reasonably accepted that the items were ancient “based on [a] rational assessment of the source and style of work.” Moreover, as to the Etruscan Warrior, Hall admittedly informed Eisenberg that he believed it to be from the private collection of renowned art collector J. Pierpont Morgan as signified by a painted red number. Eisenberg could have rationally relied on Morgan’s reputation in addition to his own observations. However, plaintiff Eisenberg also admits in its com-plaint that several other items purchased from defendants later turned out to be inauthentic. This suggests that plaintiff should have been on notice that the items might not be ancient—at least by the time of the later Etruscan Warrior purchase. The circumstances surrounding the transactions, including the visits to Hall’s townhouse and bedroom, with little or no discussion of the provenance of the pieces, as well as plaintiff’s admission that several other items purchased from defendants turned out to be inauthentic, cast plaintiff’s professed certainty as to the authenticity of the items into doubt and could support a finding that plaintiff was on notice that the items might not be ancient. DECISION AND REMEDY: Denial of plaintiff’s motion for summary judgment affirmed. SIGNIFICANCE OF THE CASE: This case shows how a court analyzes an issue of mutual mistake, as well as the “conscious ignorance” exception to the doctrine. CRITICAL THINKING The dissent in the case wrote that Eisenberg’s motion for summary judgment should have been granted. Wht do you think the reasoning for granting the motion would be? ETHICAL DECISION MAKING What values are

furthered by the outcome in this case? Page 263Page 264 E-COMMERCE and the Law Contracts have been around as long as people have been making deals, and the relatively recent advent of the Internet has changed the way we think of a vital aspect of contracts, legal assent. Unlike traditional contracts, in which assent is often confirmed either through a signature or a verbal affirmation, Internet users typically do not communicate with a web host or app developer before using a website or app. In spite of this, hosts and developers still often have a number of terms and conditions they would like users to follow when using their product. The first solution to this issue was the browsewrap agreement. Browsewrap agreements (so named due to their similarity to agreements packaged with some products under shrink-wrap) are a set of terms and conditions simply placed somewhere on a website or app. Browsewrap agreements always contain a clause stating in some manner that by using the site or app, the user agrees to these terms and conditions. The issue with browsewrap agreements, however, was that they were often placed on some obscure corner of a website or app and users rarely ever came across them. Thus, courts often ruled that browsewrap agreements were unenforceable because users often did not even know they existed, let alone agreed to them. Nowadays, most sites and apps use clickwrap agreements instead. Clickwrap agreements present a user with the terms and conditions the minute they visit a site, open an app, or begin an online purchase. To continue using the service, the user must click a box stating that they agree to the service’s terms and conditions. Clickwrap agreements bring the terms and conditions front and center and give users ample opportunity to review them, and thus these types of agreements have been held to be enforceable much more often than browse-wrap agreements.

Misrepresentation LO 12-3 Recall the elements of misrepresentation. Misrepresentations are similar to mistakes. In both cases, at least one of the parties is in error about a fact material to the agreement. But a misrepresentation is an untruthful assertion by one of the parties about a material fact. One party said something that prevented the parties from having the mental agreement necessary for a legal contract. The parties only appeared to agree, so their contract lacked legal assent. The courts insist that there must be a meeting of the minds for a valid contract. Thus, they might rescind a contract even though the person making the false assertion was entirely innocent of any intentional deception. Innocent Misrepresentation An innocent misrepresentation is a false statement about

a fact material to an agreement that the person who made the statement believed to be true. The person who made the false statement had no knowledge of the falsity of the claim. We say the person lacked scienter. In the case opener, given that Knafel's doctor had estimated the time she became pregnant to be when she was in Phoenix with Jordan, it is likely that the court would find that she did not realize that she was misrepresenting who the father of her child was. Innocent misrepresentations permit the party that was misled by the false statement to rescind the contract. However, because the party that made the false statement had no intent to mislead, the aggrieved party cannot sue for damages. The reasoning in such cases is similar to the arguments in a mutual-mistake case, as you might expect. BUT WHAT IF. . . WHAT IF THE FACTS OF THE CASE OPENER WERE DIFFERENT? Let's say that in the Case Opener, Knafel was incorrectly told by her doctor that the baby was Jordan's. She then told Jordan that she indeed was carrying his baby. Thus, Jordan signed the contract and paid Knafel a large sum of money. Later, the two found out the baby was not Jordan's. What kind of misrepresentation occurred? Can Jordan sue for damages? Page 265 Negligent Misrepresentation In some contract negotiations, one party makes a statement of material fact that he thinks is true, but he is negligent in making the assertion. Such a negligent misrepresentation results when the party making the statement would have known the truth about the fact had he used reasonable care to discover or reveal it. Even though there was no actual intent to deceive, the party making the false statement is treated in contract law as if the intent were present. If this standard seems unfair to you, remember that the courts find negligent misrepresentation only when the party making the false statement should have known the truth had they used the skills and competence required of a person in their position or profession. The impact of negligent misrepresentation is identical to that of fraudulent misrepresentation, discussed next. Fraudulent Misrepresentation Any fraud on the part of a party to a contract provides a basis for rescission. The parties cannot be said to have assented when one of the parties was tricked into the agreement by a fraudulent misrepresentation. Thus, the agreement was not voluntary and can be rescinded on the grounds that there was no meeting of the minds. Even in countries that are trying to encourage joint ventures and global commercial activity, such as China, fraudulent claims can end the country's hospitality to agreements with outsiders. In China, accusations of outsiders' fraudulent misrepresentation have resulted in heavy fines and even refusals to allow the fraudulent party to enter into any more agreements with Chinese firms. The point is that in most, if not all, cultures there is little judicial sympathy for those who

consciously mislead others in commercial activities. A fraudulent misrepresentation is a false representation of a material fact that is consciously false and is intended to mislead the other party. Fraudulent misrepresentation is intentional misrepresentation. Here, scienter is clear. The party making the misrepresentation either knows or believes that the factual claim is false or knows that there is no basis for the assertion. To understand the requirements for a finding of fraudulent misrepresentation, start with the two elements from the definition: A false statement about a past or existing fact that is material to the contract. Intent to deceive. Intent can be inferred from the particular circumstances. Then add a third necessary element: Justifiable reliance on the false statement by the innocent party to the agreement. Justifiable reliance is generally present unless the injured party knew, or should have known by the extravagance of the claim, that the false statement was indeed false. For example, a person could not justifiably rely on a claim by another that a hair on their head, although worth $1,000, was available for $10. Finally, if damages are sought, the defrauded party must have been injured by the misrepresentation. BUT WHAT IF. . . WHAT IF THE FACTS OF THE CASE OPENER WERE DIFFERENT? Let’s say that in the Case Opener, Knafel had Jordan sign a contract stipulating that he must make monthly payments to her for the baby they both believed was genetically theirs together. Then, Knafel discovered the baby was not in fact Jordan’s but did not relay the information to him. What kind of fraudulent misrepresentation occurred here? Page 266 Each of these elements can become a source of debate in any attempt to rescind a contract on grounds of fraudulent misrepresentation. Thus, it is your responsibility as a person who will be involved with dozens of contracts in your business activities to know these elements. A rescinded contract is a time-consuming and expensive business opportunity that has gone wrong. Pay careful attention to the facts in Case 12-2 and decide whether you believe the defendant committed fraud. CASE 12-2 FANTASTIC SAMS SALONS CORP. v. PSTEVO, LLC AND JEREMY BAKER United States District Court for the Northern District of Illinois, Eastern Division 2016 U.S. Dist. LEXIS 5590 (2016) FACTS: Fantastic Sams Salons entered into a franchise agreement with PSTEVO, LLC and Jeremy Baker (collectively, “PSTEVO”) in which Fantastic Sams allowed PSTEVO to operate a Fantastic Sams franchised salon. Later, Fantastic Sams initiated a lawsuit against PSTEVO seeking declaratory relief with regard to the franchise agreement. In other words, Fantastic Sams wanted a court to clearly spell out the rights that Fantastic Sams held under the agreement. PSTEVO then asserted several counterclaims, including a claim of fraudulent misrepresentation by Fantastic

Sams. PSTEVO alleged that, prior to entering into the franchise agreement, Baker met with two agents of Fantastic Sams who presented Baker with several financial disclosure documents. The documents allegedly stated that PSTEVO only needed three months' worth of working capital to open the salon, and that the salon would be profitable after this three-month period. PSTEVO alleged that the agents and Fantastic Sams knew that it would take longer than three months for the salon to be profitable, and that these misrepresentations were material because PSTEVO relied on them when deciding whether to enter into the agreement. Fantastic Sams moved to dismiss the fraudulent misrepresentation claims. ISSUE: Did Fantastic Sams have the right, under the franchise agreement, to dismiss the misrepresentation claims? REASONING: Fantastic Sams moved to dismiss PSTEVO's fraudulent misrepresentation claim by way of Federal Rule of Civil Procedure 12(b)(6). This means that Fantastic Sams was essentially arguing that PSTEVO failed to allege one or more of the key elements of a fraudulent misrepresentation claim, and therefore PSTEVO's claims were not sufficient enough to bring to trial. The court relied on the criteria for FRCP 12(b)(6) set forth in Ashcroft v. Iqbal, which stated that for a claim to survive this rule, it must be facially plausible: "A claim has facial plausibility when the plaintiff pleads factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged." When arguing why PSTEVO's claims were insufficient, Fantastic Sams pointed to a disclaimer in the franchise agreement that read, "No oral, written or visual claim or representation which stated or suggested any sales, income or profit levels was made to me, except:" after which Baker had written "none" and initialed his response. Fantastic Sams argued that Baker had signified that no claims regarding the franchise's profitability were made to Baker. Thus, PSTEVO was precluded from claiming that it relied on Fantastic Sams' or its agents' representations of the franchise's profitability because no such representations were made. Being that reliance is a necessary element of a fraudulent misrepresentation claim, Fantastic Sams argued that PSTEVO's claim necessarily fails because PSTEVO could not argue reliance. The court considered that Baker had, indeed, affirmed that no representations of profitability were made to him, as evidenced by his initials. Baker could therefore not argue that he relied on claims of profitability. The court ruled that PSTEVO's claims were not facially plausible because, lacking this reliance, PSTEVO was precluded from making a convincing claim that Fantastic Sams was liable for fraudulent misrepresentation. DECISION AND REMEDY: The court granted Fantastic Sams' motion to dismiss the fraudulent misrepresentation claims under FRCP 12(b)(6). SIGNIFICANCE OF THE CASE:

This case is important because it demonstrates the importance of being able to prove all of the elements of misrepresentation. CRITICAL THINKING According to the judge’s reasoning, it was PSTEVO’s own actions that led to the case being dismissed. Should PSTEVO have done differently? ETHICAL DECISION MAKING What general values might the court be interested in protecting in this ruling? How are they similar to values upheld by other cases in this chapter? How are they different? What opposing values are less important in these rulings? Page 267 Let’s now revisit each of the elements of fraudulent misrepresentation. Although the elements may have seemed relatively straightforward when they were presented, they become more complicated in the context of actual disagreements among parties to a contract. False Assertion of Fact For fraudulent misrepresentation to be the basis for a contract rescission, the statement of fact need not be an actual assertion. Either concealment or nondisclosure can be treated as the equivalent of an actual assertion. Concealment involves the active hiding of the truth about a material fact, for example, removing 20,000 miles from the odometer on your car before selling it to me. Nondisclosure is different because it involves a failure to provide pertinent information about the projected contract. The courts have until recently been hesitant to use nondisclosure as a basis for rescinding a contract because it is a passive form of misleading conduct. Under ordinary situations associated with a legal bargain, it is not the obligation of one party to bring up any and all facts he or she might possess. Each individual is, to a large extent, treated as a responsible decision-maker. GLOBAL Context Digital Archive Japan/Alamy Stock Photo Consumer Contracts Law in Japan In 1997, after studying the application of civil law in the country, the Japanese Social Policy Council, an advisory body to the prime minister, recognized that the environment surrounding consumers was growing more diversified, and there was a significant gap between consumers and businesses in their access to information and knowledge as well as in their negotiating power. Because it cannot honestly be said that consumers and businesses are equal, as contracting parties are presumed to be under the country’s Civil Code, the council developed a special Consumer Contracts Law. This legislation is considered to place consumers and businesses on a more equal footing in transactions. Under the Consumer Contracts Law, if a business fails to provide a consumer with information or makes misrepresentations concerning basic or other important contractual matters that are necessary for the consumer to make a judgment about the contract, and if the consumer would not have entered into the contract had the information been provided or the misrepresentation not been made, the consumer may cancel

the contract. This provision is applicable whenever a business, in trying to induce a consumer to enter into a contract, (1) fails to provide information about the contents of the contract, (2) fails to provide important information necessary for the consumer to make the decision to enter into the contract, or (3) makes misrepresentations. In many such cases, the consumer would not have been entitled to relief under the Civil Code because of its strict requirements for the application of fraud. However, courts will now find nondisclosure as having the same legal effect as an actual false assertion under certain conditions: A relationship of trust exists between the parties to the contract. In this situation, the relationship provides a reasonable basis for one person's expectation that the other would never act to defraud him or her. There is failure to correct assertions of fact that are no longer true in light of events that have occurred since the initial consent to the terms of the agreement. An illustration is my failure to inform you of the recent outbreak of rust on my rust-free car that you have agreed to purchase next month. Nondisclosure is especially likely to provide the basis for rescission when one party has information about a basic assumption of the deal that is unavailable to the other party. As a result of this logic, sellers have a special duty to disclose because they know more about the structural makeup of the item being purchased. Page 268 Intent to Deceive Scienter is present when the party accused of making the fraudulent assertion believed that the assertion was false or made the claim without any regard for whether it was true or false. Alternatively, intent to deceive is present when the party making the false statement claims or implies that he or she has personal knowledge of the accuracy of the assertion. Any resulting assent is not legal because the injured party was not allowed to join the mind of the deceiving party. The party with scienter or intent to deceive wanted the contract to be fulfilled on the basis of a falsehood. Justifiable Reliance on the False Assertion What responsibilities does the injured party have when a false assertion was made by the other party? As we said earlier, the injured party has no justifiable claim of fraud when he or she relied on assertions that should have been obviously false. Anyone who pays for a house in reliance on the claim that it was built before the founding of our country cannot later try to rescind the contract on grounds of fraudulent misrepresentation. In addition, parties to contracts cannot successfully claim they justifiably relied on a false assertion of fact when the error in the statement would have been clear to anyone who had inspected the item being exchanged. However, even this duty to inspect is declining in modern contract law. Increasing responsibility is being placed on the person who made the erroneous assertion. E-Commerce and the Law Fraudulent Misrepresentation in Social Media Online

social media offer a prime opportunity for individuals to create false identities. In some cases, these false identities are then used to communicate with unsuspecting individuals, often causing the real individuals who communicate with the misrepresented identities to experience financial or emotional harm. A tragic example of this is the case of United States v. Lori Drew, in which Drew created the false identity of a boy on the MySpace networking site. Megan Meier, a young girl, was lured by Drew and Drew's daughter to strike up a relationship with the false identity. When the so-called boy broke up with Meier, Meier unfortunately committed suicide. The prosecution of Drew was unsuccessful. A major issue with the prosecution was that there was no federal statute against cyberbullying, and the judge did not feel comfortable relying on a breach of contract premise, which would make this case of fraudulent misrepresentation equivalent to a case of computer hacking. As the likelihood of fraudulently misrepresenting an individual increases, misrepresentation must be addressed by statutes that cover all possible aspects in which fraudulent representation could occur. Source: Kim Zetter, "Judge Acquits Lori Drew in Cyberbullying Case, Overrules Jury," Wired.com, July 2, 2009.

Undue Influence LO 12-4 Recall the elements of undue influence. When legal assent is present, both parties to the agreement are assumed to have made their own choices based on complete freedom to consent to or reject the terms of the bargain. However, many factors in our lives can work together to make our choices anything but free. Undue influence refers to those special relationships in which one person has taken advantage of his or her dominant position in the relationship to persuade the other person to enter into a contract. The persuasive efforts of the dominant person must have interfered with the ability of the weaker person to make his or her own decision. When people are bargaining with their attorney, doctor, guardian, relative, or anyone else in a relationship involving a high degree of trust, they can be persuaded by unusual pressures unique to that relationship, resulting in a contract that is voidable due to undue influence. Page 269 If someone believes undue influence has occurred, asking the following questions can help establish whether there was undue influence: Was the dominant party rushing the other party to consent? Did the dominant party gain undue enrichment from the agreement? Was the non-dominant party isolated from other advisers at the time of the agreement? Is the contract unreasonable because it overwhelmingly benefits the dominant party? The more of these questions that are answered in the affirmative, the more likely

a court is to determine undue influence existed. The Case Nugget below provides an illustration of undue influence. CASE Nugget A Case of Undue Influence Evan Rothberg v. Walt Disney Pictures 1999 U.S. App 1472 Robert Jahn was a senior executive at Walt Disney Pictures until he died of complications from AIDS. Days before his death, a Disney official visited him at the hospital and convinced him to sign a release that waived his rights to approximately $2 million in employee benefits, including life insurance, stock options, bonuses, and deferred compensation. After his death, his estate sued to recover the benefits waived in the release. Disney received a motion for summary judgment, and the plaintiff appealed. In reversing the motion for summary judgment, the court ruled that the question of whether the release had been procured by undue influence was a question for a jury. The court pointed out that undue influence requires (1) undue susceptibility on the part of the weaker party and (2) application of excessive pressure by the stronger party. In this case, the first fact was self-evident. The defendant was in the hospital and was fearful that Disney would expose information that would destroy his reputation. Regarding the second element, however, the court noted that in most undue-influence cases, and this case was no exception, direct evidence is rarely obtainable and thus the jury must decide the issue on the basis of inferences drawn from all the facts and circumstances. Thus, the court said that summary judgment was improper. Page 270 Duress LO 12-5 Recall the elements of duress. Duress is a much more visible and active interference with free will than is undue influence. Duress is found when one party was forced into the agreement by the wrongful act of another. The wrongful act may come in various forms. Any of the following would trigger a successful request for rescission on grounds of duress: One party threatens physical harm or extortion to gain consent to a contract. One party threatens to file a criminal lawsuit unless consent is given to the terms of the contract. (Threats to file a civil case against a party do not constitute duress unless the suit is frivolous.) One party threatens the other’s economic interests (this is known as economic duress). For instance, Jim refuses to perform according to a contract unless Ellen either signs another contract with him or pays him a higher price than that specified in the original agreement. GLOBAL Context Steve Allen Travel Photography/Alamy Stock Photo Duress in India In Indian law, duress is referred to as coercion, or the committing of or threatening to commit any act forbidden by the Indian Penal Code to force a person into entering an agreement. To prove coercion, the plaintiff must establish that (1) there was a clear utterance of threat; (2) the threat referred to an act forbidden by the Indian Penal Code; (3) the act was committed with the intention to cause the

plaintiff to enter into an agreement; (4) there was unlawful detaining of or threat to detain any property; (5) coercion was employed by a party or by his agent; and (6) the plaintiff is a party or any other person with some interest in the agreement. Indian contract law distinguishes between physical coercion and moral coercion. Physical coercion may include threats to commit suicide. In contrast, moral coercion is synonymous with undue influence. The Indian Contract Act states that a contract is induced by undue influence when the relations subsisting between the parties are such that one of the parties is in a position to dominate the will of the other and the dominating party uses that position to obtain an unfair advantage over the other. Quite unlike the concept of duress in the United States, the Indian concept of moral coercion, or undue influence, includes the unique consideration of pardanashin ladies in contract law. In India, a pardanashin woman is a woman who lives in seclusion without communication with any male except for specific male relatives. Indian law gives protection to pardanashin ladies on the grounds that “they are ignorant so far as the worldly knowledge goes.” Any contract with a pardanashin woman is automatically presumed to have been induced by undue influence. In India, a major difference between acts of coercion and acts of undue influence is the legal consequence of each action. In cases of coercion, the agreement obtained by coercion is automatically voidable. In cases of undue influence, the contract is either voidable or is set aside. Factors that enter into the finding of undue influence include the following: Inadequacy of consideration. Inequality between the parties in regard to age, intelligence, or social status. Fiduciary relationship between the parties. Unconscionable bargains. Pardanashin women. The more of these factors present, the more likely a court is to rescind the contract on grounds of undue influence. The injured party makes the case for duress by demonstrating that the threat left him or her with no reasonable alternatives. The point is that the free will necessary for legal consent had been removed by the specifics of the threat. The following Case 12-3 is an illustration of a successful use of economic duress. Page 271 CASE 12-3 GARAGE SOLUTIONS v. MONTY J. PERSON Court of Appeals of Louisiana, Third Circuit 201 So.3D 962 (2016) FACTS: Defendant Monty J. Person began working for Garage Solutions, LLC, in March 2015. Three months into his employment, Person was sent by the owner of Garage Solutions Mark Fontenot to Rexburg, Idaho, and Little Rock, Arkansas to complete corporate training. Two days before he was scheduled to leave for training, Person was presented with three contracts. One was a non-competition contract, and the remaining two were training reimbursement contracts. The reimbursement contracts stated that Person would refund the

cost of the training if he left the company within one year of completing the training. While Person never signed the non-competition contract, he signed the two reimbursement contracts one month after the conclusion of his corporate training. In August 2015, Person left Garage Solutions, and the company filed a suit seeking compensation from Person. While Person did not raise an affirmative claim of duress, the trial court determined that the contract was unenforceable because Person was indeed under duress when he signed the contracts. The plaintiffs appealed. ISSUE: Was Person under economic duress when he signed the contracts? REASONING: The court noted that the contracts signed by Person were themselves textually sound. However, after reviewing the facts of the case, the court found the validity of the contracts to be in question. Fontenot had discussed with Person the possibility of Person signing a noncompetition agreement if he received training. However, Person wasn't presented the contracts until two days before he was scheduled to leave for training. Upon initially receiving the contracts, Person refused to sign them. Person later testified that he only signed the contracts upon returning because Fontenot refused to pay him his wages until he signed. The court then pointed to precedent holding that "[F]ear of economic deprivation has been recognized as a type of duress that will vitiate consent." Although Person did not initially raise the defense of duress, the court found there to be evidence enough to enlarge the scope of the pleadings, especially since Garage Solutions did not object. Being that Person was under duress, he did not lawfully consent to the agreements. Because there was no consent, there was no contract as well as harm to the company's goodwill and reputation. DECISION AND REMEDY: Affirmed in favor of Person. SIGNIFICANCE OF THE CASE: This case shows that even a properly-written contract can be rendered entirely invalid if the circumstances surrounding the agreement are unfair. CRITICAL THINKING Do you think the outcome of the case could have been affected if Fontenot had presented the contracts earlier? Is the timing of the contracts a nonissue? ETHICAL DECISION MAKING Do you think it is fair to the plaintiffs for the court to enlarge the defendant's pleadings to include the duress claims? What ethical values does this decision support? GLOBAL Context Digital Archive Japan/Alamy Stock Photo Defects in Assent in the Philippines The law in the Philippines is somewhat unusual in the way it limits the time for rescinding a contract. In the Philippines, if consent is given through mistake, violence, intimidation, undue influence, or fraud, contracts are valid until they are annulled. The period within which to annul such a contract is four years. In cases of intimidation, violence, or undue influence, the time period is measured from the time the defect in the assent ceases. In cases of mistake

or fraud, it is measured from the time of the discovery of the defect. Page 272 CASE OPENER WRAP-UP A Disagreement over an Agreement The trial court agreed with Michael Jordan's argument regarding a mutual mistake or fraudulent misrepresentation in the contract. Knafel appealed, and the court affirmed the lower court's decision. The court held that Knafel's representation to Jordan that he was the father met the requirements of being (1) a material fact; (2) made for the purpose of inducing Jordan to act; (3) that either was known by Knafel to be false or was not actually believed by her on reasonable grounds to be true, but Jordan reasonably believed it to be true; and (4) that was relied on by Jordan to his own detriment. Thus, the appellate court found that Knafel's representation that Jordan was the father constituted fraud. The agreement can be rescinded because Jordan would not have entered into the agreement but for the fraudulent representation made by Knafel. Even if Knafel did not act fraudulently, at the time the agreement was created both parties believed that the child was Jordan's. After the paternity tests revealed that the baby was not Jordan's, the agreement could still be rescinded based on a mutual mistake of fact. PRACTICAL TIPS for Business Managers Costly mistakes can often arise because someone is making an assumption that the other party is not making. It is a good idea, when you are about to either draft or sign a contract, to ask yourself whether there are any questionable assumptions you are making that might not be shared by the other party to the potential contract. You do not want to be sued for misrepresentation, so before you make any assertions of material fact related to a contract, make sure that you are certain of those facts. If you are about to enter into a contract with a party with whom you have what might be perceived as a dominant-subservient relationship, and you could be perceived as the dominant party, advise the weaker party to get legal advice before entering into the contract, to ensure the contract is enforceable.

SUMMARY The Importance of Genuine Assent If assent is not genuine, or legal, a contract may be voidable. For purposes of planning, it is important for people to understand the circumstances under which failure of assent may render their contracts voidable. Mistake Mistakes are erroneous beliefs about the material facts of a contract at the time the agreement is made. They may be either unilateral or mutual. Only under certain rare conditions is a unilateral mistake a basis for rescinding a contract. However, if both parties to a contract are mistaken about a material fact, either can opt to rescind the contract. In cases of mutual mistake, the agreement was not

based on a meeting of the minds, a basic criterion for legal assent. Misrepresentation Misrepresentation is an intentionally untruthful assertion by one of the parties about a material fact. An innocent misrepresentation occurs when the party making the false assertion believes it to be true. The misled party may rescind the contract. When a misrepresentation is fraudulent, any assent that is given is gained by deceit. The courts permit rescission for fraudulent misrepresentation. In addition to requiring false assertion and the intent to deceive, fraudulent misrepresentation also requires justifiable reliance on the assertion by the innocent party. “If the misrepresentation is negligent, that is, made when the defendant would have known the statement was false had he taken reasonable care before making the statement, the misrepresentation is treated the same as a fraudulent misrepresentation.” Undue Influence Undue influence refers to the persuasive efforts of a dominant party who uses a special relationship with another party to interfere with that other’s free choice of the terms of a contract. Any relationship in which one party has an unusual degree of trust in the other can trigger concern about undue influence in gaining the assent of the more dependent party. Duress Duress occurs when one party threatens the other with a wrongful act unless assent is given. Such assent is not legal assent because coercion interferes with the threatened party’s free will. For a court to rescind the agreement, the injured party must demonstrate that the duress left no reasonable alternatives to agreeing to the contract.

Point/Counterpoint The principles of legal assent are based on the belief that, in the main, each person can look out for himself or herself. Thus, parties are usually held to the agreements they make on the grounds that the terms were reached by decisions guided by the free wills of both parties. But we live in a world of rapid technological change, where chemicals, fibers, and services come in a blinding array of complexity that could make decision-making more difficult for some people. Should Contracts Made through Tweets Be Legally Binding? YES No Whether it’s spoken or handwritten, transmitted to a television screen or broadcast over the airwaves, shouted from the top of a building or tweeted in 140 characters or less, speech is speech. No matter what form speech comes in, people are legally liable for the thoughts that they express. The First Amendment grants certain protections for speech, but it is not intended to be a shield for those who wish to spew forth whatever crosses their mind without fear of consequence. When one communicates an offer under sound mind, they are, at least to

others, expressing to the rest of the world that they are willing to enter into a contract. Regardless of the mode that was used to express the offer, the offer was made and the speaker is liable for that speech. Tweets are no exception to this doctrine. Besides a possible difference in size of audience, tweets are practically no different than putting an offer in writing and posting it around town for the public to see. Moreover, by not regarding tweets as potentially contractually binding, the law will essentially be allowing people to feign offers and then rescind them even after the offer has been accepted. Any kind of agreement through Twitter is effectively one-sided in favor of the offerer because the legal system would not recognize the agreement as binding, whereas in nearly any other circumstance, written or not, the agreement would be binding. Thus, Twitter users can effectively get away with making agreements with impudence through tweets. Some would argue that, due to the ambiguous nature of text-based communication on the Internet, it's hard to tell whether or not someone is serious about what they "say" online. Therefore, we shouldn't take anything said on the Internet, especially Twitter, seriously. In reality, though, the law should take just the opposite stance: everything said online that does not include some kind of disclaimer should be taken seriously. It's simply too dangerous not to in some cases. For example, if a person threatens to kill another through Twitter, the authorities do not stop to consider whether the poster is joking, they take action. Sitting around and debating whether the threat is serious could lead to someone being killed. While the need for tweets to be taken seriously under other circumstances can be seen more clearly, the law should remain consistent and consider apparent contracts as legally serious as well if it cannot be clearly determined in the court's eyes whether or not the poster was serious. With today's rapidly advancing technology, the ways in which we communicate with each other are changing almost every day. Indeed, with its 140-character limit and focus on tiny spurts of communication, it would have been nearly impossible to predict a form of conversation as unique as Twitter. In fact, it is this uniqueness that sets Twitter apart from essentially all other types of communication. Sure, you can speak to another person in short bursts, à la tweet, but it's not quite the same thing as a mode of articulation that forces miniature messages that has spawned a culture and attitude all its own. In fact, it is this culture of accepted insignificance or nonseriousness of a single tweet that truly sets it apart from other forms of communication and therefore does not make it fit for legally binding contracts. The problem with treating tweets as serious legal speech fit for contracts is that tweets, as of yet, have not been been accepted as anything more than curt expressions of opinion or personality, or perhaps as a means

to share small bits of information with a particular group of Twitter users. Sure, people often have arguments through tweets or attempt to make profound personal statements in their petite allotment of words, but these types of tweets are often mocked for taking Twitter too seriously. The point is that Twitter has yet to be recognized as a serious form of communication, even by its users, and thus is no place for serious legally binding agreements to be invoked. Perhaps Twitter could evolve to someday be a shining star of intelligent, serious conversation, but legal discourse is simply counterintuitive to the purpose of Twitter as it stands today. In fact, if Twitter were suddenly to be considered an apt forum for legal discourse and contractual obligation, its lackadaisical tone could lead to difficulties in the area of making offers and forming contracts. For example, sarcasm is a rather popular way of expressing one's self on the Internet. Unfortunately, due to the lack of speech-based communication, with its varying intonations and volumes that aid in expressing emotion, it can be very difficult to decipher when a tweet is intended to be taken seriously or in jest. If I were to jokingly tweet, "Boy, I'm so hungry, I would give $1,000 to anyone who brought me a doughnut," have I just made an offer that someone can accept and contractually bind me to? Now of course, written contracts also lack speech to determine the intent of what is written, but said contracts are practically universally written to say just what they intend. Tweets, on the other hand, do not always intend what they actually say. Imposing a sudden expectation of contractual obligation to tweets (as has been done) simply makes no sense given the nature of tweets themselves.

Questions & Problems Explain the difference between a unilateral mistake and a mutual mistake. Explain when a unilateral mistake can lead to rendering a contract voidable. Distinguish innocent misrepresentation from fraudulent misrepresentation. Explain how nondisclosure can be treated as misrepresentation. Explain the primary differences between duress and undue influence. Kyle Connaughton was actively pursuing potential buyers for a ramen restaurant concept that he had created. Eventually, Chipotle's CEO, Steven Ells displayed interest in Connaughton's plan. Connaughton then tried to cater the design to fit Chipotle's needs. Ells initially offered to purchase the ramen restaurant concept, but eventually formed an agreement with Connaughton whereby Connaughton would continue to develop and implement the concept as a Culinary Director employed by Chipotle. Connaughton was on track to launch a restaurant in New York towards the end of his second year of employment. However, he learned

from Chipotle’s chief marketing officer (CMO) that Ells had a non-disclosure agreement (NDA) with another chef who had previously worked on the ramen restaurant concept with Chipotle. The previous arrangement ended after the two parties could not find mutually acceptable terms and the CMO informed Connaughton that the other chef would sue if the restaurant was launched. Connaughton brought up the NDA to Ells, who told Connaughton to continue working on the restaurant. Connaughton refused and was fired shortly thereafter. Following his dismissal, Connaughton sued Chipotle and Ells for fraudulent inducement, asserting that if it were not for his reasonable reliance on Ell’s omissions about the previously contracted work on the ramen restaurant concept, he would not have agreed to work with Chipotle. Furthermore, Connaughton claimed he was damaged for lost business opportunities in connection to the ramen restaurant concept and that working for Chipotle had opened him up for liability to the chef that had signed an NDA. The trial court sided with Chipotle and the plaintiff appealed. How do you think the appeals court ruled? Why? Source: Connaughton v. CHIPOTLE INC., 29 NY 3d 137 (2017). Nationwide Insurance developed a program to recruit new insurance agents by offering planning, training, and start-up financing to build self-sustaining agencies. These new agents would be independent contractors who would agree to exclusively sell and service Nationwide products. In 2005, Nationwide recruited Christine Lucarell under this program. Based on a business plan developed by Nationwide, Lucarell anticipated revenues of $200,000 a year. Nationwide provided Lucarell with a $290,000 loan to start up her agency and provided her with minimum production requirements, although Lucarell alleged that these requirements were never part of her contract. Page 275 Lucarell used the loan to start her agency in 2006, renting and furnishing office space, hiring two employees, and throwing a grand-opening party. Lucarell initially exceeded her minimum production requirements and won awards for her performance but eventually began having difficulty bringing in new customers and maintaining her cash flow. In 2007, Lucarell met with her sales manager and signed an agreement in which Nationwide would provide her with $15,000 and reimburse $35,000 in business expenses in exchange for her to “completely release and forever discharge any and all claims which Agent may have against Nationwide. . .” Lucarell testified that when she signed the agreement, she had “no choice . . . They would have terminated me and my agency, and my loan would become due in full.” Nationwide provided Lucarell with a new business plan, but she continued to fall short of the minimum requirements. Lucarell eventually resigned in 2009. Lucarell sued Nationwide for breach of her agreement and fraudulent misrepresentation. Nationwide counterclaimed for

the balance due on her loan. Lucarell claimed that Nationwide had lied to her about the potential success of her agency, and then forced her to sign the second agreement under duress of enforcing the loan against her. The trial court found in favor of Lucarell on all claims. Nationwide appealed. How do you think the appellate court ruled? Was Lucarell truly under duress when she signed the second agreement? Lucarell v. Nationwide Mut. Ins. Co., 152 Ohio St.3d 453, 2018-Ohio-15. Source: Martha Rochelle v. Hartley Mead, 2015 Conn. Super. LEXIS 2587 (2015). In 2013, Thomas DePrince, a passenger aboard a cruise ship, visited the ship's jewelry boutique, operated by Starboard Cruise Services, Inc. DePrince told the employees of the boutique that he was interested in purchasing a loose, 20-carat diamond. The boutique itself did not carry diamonds of that size, so the store's manager emailed Starboard's corporate office to inquire about the availability of such a gem. The manager, in turn, contacted a diamond broker in New York, who listed two diamonds, one with "selling price of $235,000." The employees sold the diamond to DePrince for $235,000 and told him that the diamond would be waiting for him when the ship docked. There was just one problem, however: the Starboard employees had never sold a large loose diamond before, and did not realize that the quoted price was per carat. In other words, the true price of the diamond was $4.7 million, and they had contracted to sell it for $235,000. After realizing their mistake, the employees reversed the charge and told DePrince that the sale was off. DePrince sued to enforce the contract. Starboard claimed it should be able to rescind the contract due to unilateral mistake. How should the court rule in this case? DePrince v. Starboard Cruise Services, Inc., No. 3d16-1149, 2018 W 443153 (Fla. 3d DCA 2018). Audrey Vokes was a 51-year-old widow who wanted to become an accomplished dancer. She was invited to attend a dance party at J. P. Davenports's School of Dancing, an Arthur Murray franchise. She subsequently signed up for dance classes, at which she received elaborate praise. Her instructor initially sold her eight half-hour dance lessons for $14.50 each, to be used one each month. Eventually, after being continually told that she had excellent potential and that she was developing into a beautiful dancer—when in fact she was not developing her dance ability and had no aptitude for dance—she ended up purchasing a total of 2,302 hours' worth of dance lessons for a total of $31,090.45. When it finally became clear to Vokes that she was not developing her dance skills, in part because she had trouble even hearing the musical beat, she sued Arthur Murray. What would be the basis of her argument? Her case was initially dismissed by the trial court. What do you think the result of her appeal was? Source: Vokes v. Arthur Murray, 212 So. 2d 906 (1968). The W.C.

Bradley Company needed help with a major software overhaul. W.C. Bradley contacted itelligence, Inc., to handle to overhaul. itellgence told W.C. Bradley that it had experienced employees that could meet W.C. Bradley's software needs. After extensive negotiations, the two firms entered into an agreement for the implementation of a new software system. However, according to W.C. Bradley, things went downhill from here. W.C. Bradley claimed that although itelligence had knowledgeable personnel who said all the right things during negotiations, the employees sent to actually handle the project did not have the capability or expertise to implement the new software system successfully. After the first major rollout of the new software failed, W.C. Bradley threatened to fire itelligence. itelligence responded by saying it would fix the problems, and W.C. Bradley gave itelligence a second chance. itelligence charged W.C. Bradley for these fixes, and yet the software still failed to work properly. W.C. Bradley terminated the contract and brought suit against itelligence. What claims do you think W.C. Bradley advanced against itelligence? How do you think the court ruled on those claims? WC Bradley Co. v. itelligence, Inc., No. 4: 17-CV-208 (CDL) (M.D. Ga. 2018). Page 276 Patty Hayes owned four Personal Seat Licenses ("PSLs") at the Cleveland Browns Stadium. Hayes's PSLs reserved four seats on the 50-yard line, at the railing, on the north side of the stadium. As the owner PSLs, Hayes was obligated each year to purchase season tickets for the seats which she could then use or sell. Failure to purchase season tickets would result in the PSLs reverting back to the Cleveland Browns and the seats being available to those on a waiting list. Donald Younker heard about Hayes's PSLs through a coworker. Younker communicated with Hayes through email and purchased Hayes's season tickets at face value for the 2014 and 2015 seasons. At the end of the 2015 season, Younker asked Hayes if she would sell the PSLs to him. Hayes claimed that she paid $8,000 for the four PSLs and would like to receive $4,000 for them. Younker agreed and sent Hayes a check for the full amount. Afterward, Hayes contacted the Cleveland Browns' front office to execute the neces-sary transfer paperwork. The front office told Hayes that the PSLs were worth approximately $10,000 each and that there was a 40-year waiting list for those seats. Based on this information, Hayes advised Younker that she could not commit to selling him the PSLs for $4,000. Younker filed a complaint for breach of contract and sought specific performance and money damages. The trial court ruled in favor of Hayes in terms of damages on the grounds of mutual mistake. Younker appealed. Do you think the court incorrectly applied the doctrine of mutual mistake here? Why or why not? Younker v. Hayes, 108 N.E.3d 258 (Ohio App. 9th Dist., 2018). In 2016, a father of two minor children in Cuyahoga County, Ohio,

filed a claim to determine custody of the children. At the pretrial, the father informed the magistrate he wanted to be named a legal custodian because he paid child support. The magistrate appointed a guardian ad litem, a third party that considers the best interests of the children, to work with the couple and come to a resolution. On the day of the the trial, the mother and father informed the court they had settled the matter. The mother and father signed an agreement that was approved by the guardian ad litem. The agreement detailed that the children would live with the mother, subject to the father's visitation rights as set out in the agreement. The agreement was incorporated into the magistrate's decision, with the magistrate designating the mother as the legal custodian and residential parent. The father appealed the decision, asserting that because of a unilateral error on his part, where he thought he was signing a shared parenting agreement, the judgment should be overturned. Do you think the father has grounds to assert a unilateral mistake? What kind of evidence would the father need to successfully make his case? Source: IN RE JW, 2017 Ohio 8486 (2017).